

AUDIT MEETING OF MAY 5, 2011

Leslie Bingham-Escareño, Chair



Tom Gann, Member
Lowell Keig, Member

BOARD SECRETARY
BOARD ACTION REQUEST
MAY 5, 2011

Presentation, Discussion, and Possible Approval of the Audit Committee Meeting Minutes Summary for January 19, 2011.

Recommended Action

Approve Audit Committee Meeting Minutes Summary for January 19, 2011.

RESOLVED, that the Audit Committee Meeting Minutes Summary for January 19, 2011, is hereby approved as presented.

**AUDIT COMMITTEE
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS**

JANUARY 19, 2011; 5:00 P.M.

TDHCA HEADQUARTERS
221 E. 11TH STREET, ROOM 116
AUSTIN, TX

SUMMARY OF MINUTES

CALL TO ORDER, ROLL CALL; CERTIFICATION OF QUORUM

The Audit Committee Meeting of the Texas Department of Housing and Community Affairs of January 19, 2011 was called to order by Chair, Gloria Ray, at 5:00 p.m. It was held at the 221 E. 11th Street, Room 116, Austin, TX. Roll call certified a quorum was present.

Members Present:

Gloria Ray, Chair
Tom Gann, Member
Lowell Keig, Member

PUBLIC COMMENT

The Audit Committee of the Board of the Texas Department of Housing and Community Affairs will solicit public comment at the beginning of the meeting and will also provide for public comment on each agenda item after the presentation made by the Department staff and motions made by the Committee.

No public comment.

The Audit Committee of the Board of the Texas Department of Housing and Community Affairs will meet to consider and possibly act on the following:

REPORT ITEMS

AGENDA ITEM 1 PRESENTATION, DISCUSSION, AND POSSIBLE APPROVAL OF AUDIT COMMITTEE MINUTES FOR NOVEMBER 9, 2010.

Motion by Mr. Keig to approve staff recommendation; duly seconded by Mr. Gann; passed unanimously.

AGENDA ITEM 2 PRESENTATION, DISCUSSION AND POSSIBLE ACTION ON THE 2011 AUDIT COMMITTEE CHARTER AND BOARD RESOLUTION #11-017.

Motion by Mr. Gann to approve staff recommendation; duly seconded by Mr. Keig; passed unanimously.

AGENDA ITEM 3 PRESENTATION AND DISCUSSION OF AUDIT RESULTS FROM DELOITTE AND TOUCHE, CPAS.

-Communications with Audit Committee
-Opinion Audit on FY 2010 Basic Financial Statements
-Opinion Audit on FY 2010 Revenue Bond Program Financial Statements
-Opinion Audit on FY 2010 Computation of Unencumbered Fund Balances

Motion by Mr. Keig to accept the Deloitte and Touche Audit Report and to recommend to the full board, acceptance of the audit; duly seconded by Mr. Gann; passed unanimously.

AGENDA ITEM 4 PRESENTATION AND DISCUSSION OF THE STATUS OF THE INTERNAL AUDIT WORK PLAN.
Report item only. No action taken.

AGENDA ITEM 5 PRESENTATION AND DISCUSSION OF RECENT INTERNAL AUDIT REPORTS
Report item only. No action taken.

AGENDA ITEM 6 PRESENTATION AND DISCUSSION OF THE STATUS OF EXTERNAL AUDITS
Report item only. No action taken.

AGENDA ITEM 7 PRESENTATION AND DISCUSSION OF RECENT EXTERNAL AUDIT REPORTS
Report item only. No action taken.

AGENDA ITEM 8 PRESENTATION AND DISCUSSION OF THE STATUS OF PRIOR AUDIT ISSUES
Report item only. No action taken.

EXECUTIVE SESSION

No Executive Session was held.

ADJOURN

Since there was no further business to come before the Committee, Gloria Ray adjourned the meeting of the Audit Committee at 6:00 p.m. on January 19, 2011.

Michele Atkins, Assistant Board Secretary

For a full transcript of this meeting, please visit the TDHCA website at www.tdhca.state.tx.us.

**INTERNAL AUDIT DIVISION
BOARD ACTION REQUEST
MAY 5, 2011**

Presentation, discussion and possible approval of the internal audit work plan.

Recommend Action

Approve the revised internal audit work plan.

RESOLVED, that the revised internal audit work plan is hereby approved as presented.

Background

A revision to the internal audit work plan is requested to expand the audit of the Disaster Recovery Program – Hurricane Ike to a more general review of the entire Disaster Recovery Program. In addition, the start of the tax credit exchange program was moved from July to April.

Department of Housing and Community Affairs
Internal Audit Division – Fiscal Year 2011
Status of Internal Audit Plan (as of May 2011)

Program Area/Division	Audit	Status	Comments
NSP	Neighborhood Stabilization Program	Reporting	Report Released
Information Systems	An Audit of Information Technology Governance	Completed	Report Released
Community Affairs	Weatherization Program	January 2011	Report Released
Disaster Recovery	Disaster Recovery Program	April 2011	Planning
Multi-Family	Tax Credit Exchange Program	April 2011	Planning
HOME	Tax Credit Assistance Program	January 2011	Report Released
Program Area/Division	Management Assistance/ Special Projects		Comments
Internal Audit	Conduct Annual Risk Assessment and Prepare Fiscal Year 2011 Audit Plan	Completed	Required by the Texas Internal Auditing Act and by Audit Standards
Internal Audit	Review and Revise Internal Audit Charter	Completed	Required by Audit Standards
Internal Audit	Quality Assurance Self-Assessment Review	Completed	Required by Audit Standards
Internal Audit	Review and Revise Internal Audit Policies and Procedures to Comply with New Auditing Standards	August 2011	The GAO Will Be Releasing A Revised Version of the Government Auditing Standards
Internal Audit	Configure Teammate Audit Software	June 2011	Moved from March to June
Internal Audit	Preparation and Submission of the Fiscal Year 2010 Annual Internal Audit Report	Completed	Required by the Texas Internal Auditing Act
Internal Audit	Coordinate with External Auditors	Ongoing	Ongoing Requirement
Internal Audit	Monitor ARRA Issues	Ongoing	Ongoing Requirement
All Divisions	Follow-up on the Status of Prior Audit Issues	Ongoing	Required by Audit Standards
All Divisions	Tracking the Status of Prior Audit Issues	Ongoing	Required by Audit Standards
All Divisions	Tracking, Follow-up and Disposal of Fraud Hotline Calls	Ongoing	Internal Audit is Responsible for the Fraud Hotline

**INTERNAL AUDIT DIVISION
BOARD REPORT ITEM
MAY 5, 2011**

Presentation and discussion of recent internal audit reports.

Recommend Action

No action required; information only.

Background

The following internal audit reports were recently released:

- **An Audit of the Neighborhood Stabilization Program**
The Neighborhood Stabilization Program (NSP) is not operating as efficiently as it could be and may not be fully in compliance with all program rules and federal requirements. NSP lacks the internal controls and effective communication needed for its success. Due to data limitations, information is not always accurate, complete or available in a timely manner. Due to tight federal timeframes, NSP was launched without implementing sufficient internal controls or program guidance.
- **An Audit Report on the Weatherization Assistance Program**
The Weatherization Assistance Program (WAP) has effective procedures in place to predict, identify and prevent program weaknesses at the subrecipient level. However, WAP should further strengthen and formalize the processes it uses to prevent, detect or identify fraud, waste or abuse. Although the monitoring instrument used to evaluate subrecipients is comprehensive and effective, there are opportunities to enhance the monitoring procedures. In addition, WAP needs a centralized location to document and track complaints as well as fraud, waste or abuse allegations.
- **An Audit Report on the Tax Credit Assistance Program**
The Department correctly awarded \$148.4 million in funds to eligible tax credit projects as required by the U. S. Department of Housing and Urban Development (HUD.) We reviewed the application and scoring process used by the Department to award TCAP funds as well as the contracts and amendments for all TCAP projects and found no errors. The Department paid draws (requests for payment) for expenses associated with TCAP projects in accordance with the program's requirements, the Department's procedures, and applicable laws and regulations. The Department met all of the TCAP reporting requirements and is providing HUD with accurate, complete, and timely data.



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

www.tdhea.state.tx.us

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J. Paul Oxeer

April 8, 2011

To: The Governing Board and Audit Committee Members of the Texas Department of Housing and Community Affairs

Re: Internal Audit Report on the Neighborhood Stabilization Program

Attached is the internal audit report on the Texas Department of Housing and Community Affairs' (Department's) Neighborhood Stabilization Program (NSP or program). NSP is not operating as efficiently as it could and may not be fully in compliance with all program rules and federal requirements. NSP is a large, high-profile program which is operating on an abbreviated timeline. Prompt action is necessary to help ensure the success of the program. Opportunities for improvement include strengthening the internal controls, enhancing communication, improving program processes and ensuring compliance with key program requirements.

NSP's internal controls should be strengthened. Internal controls include activities essential to support the achievement of the program's objectives, ensure information is accurate and reliable, ensure compliance with rules and regulations and safeguard assets. NSP's internal control weaknesses include not sufficiently segregating duties, not performing reconciliations on a regular basis, not always recording transactions timely, not consistently maintaining appropriate documentation, and not finalizing their draft policies and procedures.

NSP's communication should be enhanced. Successful communication and reliable information are vital to the success of any endeavor. Pertinent information is not always accurate, complete or available in a timely manner. In addition, the information may not be communicated adequately to subgrantees and other divisions which have a role in NSP's processes.

Key program processes should be improved and monitored in order to ensure compliance with the program's objectives and requirements. We observed, analyzed and evaluated key processes such as setting up contracts, drawing down funds and documenting amendments. We found that contracts are not always set up accurately, draws are not always processed timely, and amendments are not adequately tracked.

In addition to making changes to NSP, the Department should increase its capacity to handle the program's anticipated loan closings. We evaluated the resources currently committed to NSP. High production and backlogs in some areas appears to have an impact on the quality of work. As a result, the resources allocated to NSP may not be sufficient to handle the volume of anticipated transactions.

Without prompt corrective action, the Department is at risk of not achieving its objectives for NSP. Many of the challenges that NSP encounters could be resolved by strengthening the program's internal controls, enhancing communication with key stakeholders, ensuring the effectiveness of key processes and reallocating resources. Management's response indicates a commitment to addressing the concerns presented. Moreover, management is currently in the process of implementing our audit recommendations.

The overall objective of this audit was to determine whether NSP is operating effectively and in compliance with laws, regulations and program requirements. The audit scope included NSP1 for the period from September 2009 through November 2010. Our fieldwork was conducted from November 2010 through January 2011. This audit was conducted in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing.

If you have any questions about this audit, please contact me at (512) 475-3813. We appreciate the assistance and cooperation we received from management and staff.

Sincerely,



Sandra Q. Donoho, MPA, CISA, CIA, CFE, CICA
Director of Internal Audit

Encl. (1)

cc: Michael Gerber, Executive Director
Tim Irvine, General Counsel and Chief of Staff
Tom Gouris, Deputy Executive Director for Housing Programs
Marni Holloway, Manager, Neighborhood Stabilization Program

Executive Summary

The Texas Department of Housing and Community Affairs' (Department) Neighborhood Stabilization Program (NSP) is not operating as efficiently as it could and may not fully comply with all program rules and federal requirements. The program does not have the level of internal controls and effective communication needed for its success. Due to data limitations, information is not always accurate, complete, or available in a timely manner. Key program processes need improvement in order to ensure compliance with program rules and federal regulations. Due to tight timeframes, the NSP was launched without implementing sufficient internal controls needed to ensure the program's success. The demands of operating the program has consumed a large majority of the NSP staff's time, further delaying the development and implementation of internal controls and other needed program guidance. A delay in implementing program guidance has also resulted in inefficiencies.

Internal controls include policies and procedures, approvals, authorizations, verifications, reconciliations, reviews, segregation of duties, accurate and timely recording of transactions, and appropriate documentation of transactions. Currently, the NSP does not segregate duties, does not perform reconciliations on a regular or routine basis, does not record transactions timely, does not maintain appropriate documentation in the Department's Housing Contract System to support transactions, and does not have finalized policies and procedures. In addition, key program elements are not monitored. For example, NSP is not tracking the subgrantees' milestones and some of these milestones have not been met.

The NSP lacks effective communication. Key program processes are not always communicated to staff. Communication between NSP and other divisions within the Department are not always effective, which results in other divisions developing compensating processes in order to manage their NSP workload. The bulk of the program knowledge is possessed by the NSP manager, who has not formally documented nor regularly shared this information with other NSP staff. Pertinent information may not be communicated clearly and in a timely manner. NSP staff have varied job responsibilities and work under tight deadlines. In these conditions, effective communication is essential to program success.

We evaluated the program's internal controls and how the NSP records, maintains, reports and communicates information. We evaluated the effectiveness of key processes such as setting up contracts, drawing down funds and documenting amendments. We evaluated the Department's

The Neighborhood Stabilization Program (NSP)

NSP is a HUD-funded program authorized by the *Housing and Economic Recovery Act of 2008* (HERA). NSP provides funds to purchase foreclosed or abandoned homes and to rehabilitate, resell, or redevelop these homes in order to stabilize neighborhoods and stem the decline of values for neighboring homes.

Texas received \$101,996,848 in NSP1 funds, of which \$19,981,500 (19.6%) is administered by the Texas Department of Rural Affairs (TDRA).

As of January 27, 2011, the Department disbursed \$27,060,528 for NSP1 Activities. This is 26.5% of the total NSP1 funding.

TDHCA will receive \$7,284,978 in NSP3 funds and anticipates receiving over \$10 million in program income over the next 22 months.

Source: HUD's Disaster Recovery Grant Reporting System (DRGR).

ability to meet the demands of the program given its current resources. We also evaluated compliance with key program requirements. We tried to confirm that the NSP met its September 3, 2010 deadline to obligate funds but we were unable to do so accurately because of data limitations.

Many of the challenges the NSP encounters could be resolved by implementing and strengthening the program's internal controls. In addition, enhancing communication within the program and between the program and other areas of the Department involved in administration of the program could help the NSP run more effectively and efficiently. Ensuring the effectiveness of key processes would also further safeguard program assets.

Other Key Points

- Texas Department of Rural Affairs (TDRA) draws are not monitored by NSP staff prior to payment. TDRA is responsible for the administration of \$19,981,500 (19.6%) of the \$101,996,848 NSP grant from HUD.
- Draws are not always processed in a timely manner and draw documentation in the Housing Contract System is not always complete. Of the 77 judgmentally selected draws we tested, 18 (23.4%) were not processed within five days; the longest time delay was forty-two working days. In addition, the checklists developed to perform the draw process are not used effectively.
- The Department currently does not have enough resources to meet the deadline for 400 loan closings, and the anticipated workload for the Legal Division in preparing loan documentation is challenging. In addition, loan files provided to legal by NSP are not always complete or accurate, further delaying the loan closing process.
- The NSP is not consistently following HUD's program requirements or the requirements set out in the Department's Notice of Funding Availability (NOFA). NSP did not submit an annual Section 3 Report for 2009 as required by HUD. Section 3 requires the Department and its subgrantees to give priority to low and very low-income people in the community when awarding opportunities for jobs, training or contracts using HUD funds.
- The NSP did not abide by the \$525,000 minimum award amount set out in the Department's Notice of Funding Availability (NOFA). One original contract in our sample was written for less than \$525,000. In addition, NSP staff have not confirmed some contract terminations in writing as required by the contracts.

Summary of Recommendations

- NSP should implement a monitoring process for all draws initiated by TDRA to ensure that all draws are processed correctly and within the program's requirements.

An Audit of the Neighborhood Stabilization Program

- NSP should ensure that all draws are processed within the required time frame and that the required supporting documentation is available in the Housing Contract System prior to approving payment of the draw. NSP should also improve the use of draw checklists and ensure that they are completed correctly.
- The Department should re-evaluate the resources of the NSP and reallocate staff as necessary to ensure that there are an adequate number of loan closers to complete the anticipated influx of closings. In addition, NSP should require subgrantees to coordinate loan closing deadlines with the Department, enhance their quality assurance reviews and ensure that the Legal Division receives all documents required for loan preparation.
- The NSP should submit the Section 3 Reports to HUD as required.
- The NSP should award all program funds consistent with the NOFA and confirm all contract terminations in writing as required by the contract.

Summary of Management's Response

Management's responses indicate a commitment to addressing the concerns presented in this report. Management is currently in the process of implementing the recommendations.

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Detailed Results

Chapter 1

Increased Internal Controls and Enhanced Communication Could Improve the Effectiveness of the Neighborhood Stabilization Program

The Neighborhood Stabilization Program (NSP) lacks sufficient internal controls to ensure the program's success. Internal controls include diverse activities such as policies and procedures, approvals, authorizations, verifications, reconciliations, reviews, segregation of duties, accurate and timely recording of transactions, and appropriate documentation of transactions. Currently, the NSP does not segregate some duties, does not perform reconciliations on a regular or routine basis, does not always record transactions timely, does not consistently maintain appropriate documentation in the Housing Contract System to support transactions, and has not finalized its policies and procedures. In addition, the draft policies and procedures have not been effectively communicated to staff.

Due to tight timeframes, the program was launched without implementing basic internal controls such as policies and procedures, segregation of duties, and a plan for maintaining supporting documentation. The demands of operating the program have consumed a large majority of the NSP team's time, further delaying the implementation of controls and other needed guidance. Not implementing the needed internal controls has resulted in inefficiencies and could impact the effectiveness of the program.

The Department emphasizes the importance of internal controls in Standard Operating Procedure (SOP) 1109.09 which states, "The implementation and maintenance of a well-documented system of internal controls is one of the Department's highest priorities. Such a system is the overall plan of organization and the methods employed by the Department to help ensure that the goals and objectives of the Department are achieved and to account for and safeguard its assets from loss, to ensure reliable accounting data and information systems, to promote efficient operations, and to ensure compliance with Department policies and all applicable laws and regulations."

Many of the challenges the NSP encounters could be resolved by implementing and strengthening internal controls. In addition to internal controls, enhancing communication within the NSP and between the program and other areas of the Department involved in administration of the program could help the NSP run more effectively and efficiently.

Chapter 1-A

Duties in the Housing Contract System Should be Separated

Program Services Division staff working in NSP perform duties that should be separated. Three NSP quality assurance specialists in Program Services have level one authority to approve activity setup, amendments, and draws, and level two authority to approve activity setup, amendments and draws. This means that the quality assurance specialist could enter an activity into the Housing Contract System and also approve the same transaction.

Separation of duties is an important internal control that dictates that no one individual should control all key aspects of a transaction or event. Separating responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets will help mitigate the risk of errors and irregularities and assist in safeguarding assets.

Recommendation

NSP should ensure individuals who enter activities into the Housing Contract System do not also have the authority to approve the transactions that they set up.

Management's Response

Management concurs. Overlap of authority in the Department's dual approval authority has occurred in the Program Services Division as a result of the administration of another program. Management will ensure that the separation of duties for the entry and approval of draws and set-ups in the Housing Contract System (HCS) are re-established and staff duties reassigned to restore checks and balances by March 31, 2011.

Management will review and edit existing draft SOPs concerning HCS procedures or new SOPs will be created to ensure that these roles do not overlap again. The applicable SOPs will be developed and finalized by May 30, 2011.

Chapter 1-B

Key Program Elements Should be Monitored

NSP does not have an established mechanism in place to track key elements of the program including contract milestone thresholds, cumulative budget transfer amounts, and homebuyer loan files.

Although the NSP Technical Guide states that the Department will evaluate compliance with contractual obligations to ensure progress toward meeting benchmarks, NSP is not consistently tracking the subgrantees' milestones. Subgrantees are not always meeting their milestones. In one instance, the subgrantee should have expended \$60,000 (30.0% of its demolition obligation) by May 31, 2010 (9 months after the contract date) and \$153,397 (30.0% of its purchase and rehabilitation obligation) by August 31, 2010 (12 months after the contract date). As of January 10, 2011, all the contract activities entered in the Housing Contract System for this subgrantee are still in pending status. The subgrantee has not drawn any funds to support meeting the 30% expended milestone threshold. This is significant because HUD requires grantees to obligate and expend funds in an expeditious manner and HUD has imposed a deadline for expending grant funds. If the NSP fails to expend the grant funds within the established timelines, the grant funds will be recaptured by HUD, the subgrantee's geographic area will not be served, and the Department may not achieve the program objectives.

NSP is also not formally tracking incremental budget transfers. The NSP contract with subgrantees indicates that there is a 10% budget transfer ceiling. Transfers above 10% require an

An Audit of the Neighborhood Stabilization Program

amendment or written authorization from the Department. Transfers above 25% require approval of the Department's governing board. When the cumulative amount of budget transfers is not monitored, program specialists and management may not identify incremental budget transfers that exceed the allowable limits and may neglect to obtain the appropriate level of approval.

There is no centralized mechanism to track the progression of homebuyer loans through the inter-divisional, multi-step closing process. Individuals involved in NSP loan processing have developed their own tools to track these loans. For example:

- a homebuyer loan closing specialist is tracking the status and timing of loans using Microsoft Outlook calendar notifications,
- a contract administrator loan closing specialist is tracking loan files in a spreadsheet she developed, and
- a legal staff member responsible for preparing loan documents has developed a spreadsheet to record the status of files in the legal queue.

NSP does not have a system or report that captures the entire population of NSP transactions. No single resource can be used to determine the status of the program or to review complete information about a specific transaction.

Monitoring is necessary to measure and evaluate performance and ensure that the primary stakeholders are operating within acceptable limits. If NSP does not sufficiently monitor these key elements, there is an increased risk that the program may not stay on track and that the program objectives will not be completely achieved. Missed milestones could result in the loss of funding. Budget transfers could exceed the 10% ceiling, which may prevent the amendment from receiving approval as required. Homebuyer loan files could fall through the cracks and result in delayed closings or unnecessary re-work.

Recommendations

NSP should:

- establish a system for tracking key program elements,
- ensure grant funds are expended within the program guidelines and within the program timeframe, and
- monitor contract milestone thresholds, cumulative budget transfer amounts and the status of homebuyer loan files.

Management's Response

Management concurs. Management will establish a system for tracking key program elements and formally incorporate the procedures into an SOP by May 31, 2011 in order to better track subrecipient performance and compliance.

Management will prepare a budget transfer reconciliation report for the May 2011 TDHCA Board meeting and request, if necessary, authorization for any already identified transfers at

that meeting and will establish a more uniform process to manage cumulative budget transfers by May 31, 2011.

Chapter 1-C

Policies and Procedures Need to be Finalized and Formally Communicated to Staff

NSP does not have detailed policies and procedures. The limited number of written policies and procedures NSP does have are all in draft form and have not been formally communicated to staff. The policies and procedures for contract amendment requests, draw requests, and set-up requests were in draft form as of October 4, 2010, even though the effective date was April 18, 2010. In addition, the policies and procedures for loan closings were still in draft form as of November 3, 2010. The policies and procedures developed by NSP and used by TDRA for contract administration, mortgage loan financing, home buyer assistance loans, and obtaining credit reports were also still in draft form. The draft policies and procedures that do exist have not been formally communicated to staff.

Policies and procedures are internal controls that help ensure that management directives are carried out. Without finalizing and formally communicating policies and procedures to the NSP staff, staff may not be performing their job duties as intended by management. NSP management's finalization of the policies are necessary to ensure that all program specialists are performing their duties in accordance with standardized instructions, that program specialists perform their duties consistently and effectively, and that risks are mitigated.

The Department emphasizes in its SOPs that management at all levels shall develop, document, maintain, and enforce internal control policies and procedures. It further states "the implementation and maintenance of a well documented system of internal controls is one of the Department's highest priorities."

Recommendation

NSP management should finalize, communicate, and monitor compliance with the program's written policies and procedures.

Management's Response

Management concurs. Management will reevaluate the four existing draft SOPs, edit or create new SOPs as appropriate and finalize and communicate the SOPs to staff by May 30, 2011. Management will provide training on the SOPs for staff once they have been finalized.

Management will establish a process for periodic sampling and testing to ensure compliance with written policies and procedures by August 31, 2011.

Chapter 1-D

Communication with Key Stakeholders Should be Improved

Pertinent information is not always effectively shared among NSP staff and with others that support the program. Communication between NSP and the subgrantees also appears to be challenged. As discussed in Chapter 4, subgrantees commit to move-in dates and deadlines with prospective homebuyers without consulting the Department. As a result, NSP and the Legal Division are often rushing to meet deadlines they did not set. This process puts undue pressure on the Department's staff to complete work under unreasonable timelines and increases the risk of errors or omissions.

Other barriers to effective communication and information sharing include:

- regular NSP team meetings are not conducted,
- policies and procedures have not been finalized and communicated to staff, and
- the NSP Program Manager possesses significant program knowledge that is not documented or communicated to staff.

There is a general feeling from other divisions in the Department that communication with the NSP staff is not always as effective as it could be. NSP staff has pressing deadlines and varying job responsibilities which makes effective communication important. One of five essential components of an effective internal control system is information and communication. This control supports all the other control components by communicating responsibilities to employees and by providing information in a form and timeframe that allows employees to carry out their duties effectively. If staff is not adequately informed, they may be unable to fulfill their duties and the program may be impacted.

Recommendations

Communication within NSP and with other key stakeholders should be enhanced. NSP should:

- instruct subgrantees to communicate with the Department prior to setting deadlines for move-in with homebuyers,
- conduct regular team meetings (inviting both Program Services and Legal Division staff) to discuss both broad and specific program-related issues,
- finalize and effectively communicate the draft policies and procedures, and
- share pertinent information with other staff.

Management's Response

Management concurs. Management will enhance the communication of program procedures and requirements with stakeholders, subrecipients and staff through conducting trainings, regular staff meetings and the development and finalization of written program guidance.

From November 30, 2010 through December 9, 2010, NSP staff conducted four mandatory trainings in Austin, Dallas, Houston and McAllen for all NSP subgrantees that will be reselling NSP properties. The trainings included the requirements for setting deadlines for move-in with homebuyers and established a specific email address (nsphbdocs@tdhca.state.tx.us) to facilitate

An Audit of the Neighborhood Stabilization Program

homebuyer procedures that were not being adequately and timely communicated due to limitations of the Housing Contract System. NSP will continue to schedule trainings and webinars and offer direct technical assistance where performance issues with subgrantees are identified.

Management will review and revise the NSP Technical Manual to provide an enhanced roadmap for subrecipients by May 30, 2011.

Management also concurs that effective internal communication is vital to the continued success of the NSP, helping to balance workload priorities and available time and staff resources. Management will work to ensure that communication regarding the timelines for closing activities is well understood by all internal staff and coordinated with external participants in the program.

Chapter 2

NSP Data Should be Accurate, Complete and Timely

The level of accuracy, completeness and timeliness of the NSP's data impacts the usefulness of the information. NSP management cannot go to a central location to obtain information regarding the status of the program or to review complete information about a specific transaction. Some data is maintained in the Housing Contract System, some data is available in the hard copy contract file, and some data is available in the program's shared network drive. However, there is not a synchronized reporting system that management can utilize to obtain the needed information.

The Department reports to HUD using the DRGR system. We found that information in the DRGR system does not always agree with the Department's Housing Contract System and the data is not reconciled on a regular or routine basis. The Housing Contract System is considered the system of record for the NSP and the draft policies and procedures instruct employees to enter information into the Housing Contract System. However, supporting documentation related to setups, draws and amendments is often unavailable in the system. In addition, NSP staff does not accurately update the Housing Contract System when triggering events occur such as contract expirations or voluntary terminations. As a result, the contract status was not accurate in several instances. Consequently, the Department may be inaccurately reporting information to HUD, and program managers who use the data in the contract file and the Housing Contract System for decision-making may be relying on incorrect data.

The lack of documentation in the Housing Contract System along with its dynamic nature prevented us from confirming the population of obligations in the system as of September 3, 2010, the deadline for obligating NSP funds. As a result, we could not test the obligations for compliance with the program requirements such as ensuring purchase contracts or construction contracts were in place at the time the obligation was recognized. Without concrete data, we could not confirm that the obligations were satisfied as of the deadline.

Some of the data in the Housing Contract System is generic. The Housing Contract System was created for the HOME Program; it was not developed to accommodate the NSP. As a result, subgrantees were instructed to use generic data for the household name field. However, this generic data does not follow a consistent nomenclature, which makes the data difficult to identify easily.

NSP should strengthen the integrity of its data by insuring that it is accurate, complete, and available in a timely manner.

Chapter 2-A

Budget Amounts in DRGR and the Housing Contract System Should be Reconciled

The Department may not be reporting accurate information to HUD. There were discrepancies in the total budgeted amounts recorded in the Department's Housing Contract System and the budgeted amounts recorded in the DRGR system. Of the 52 contracts that we compared in both

the DRGR and Housing Contract System, differences were noted in 26 contracts (50.0%). Four contracts had differences of \$1 million or more. One contract differed by more than \$5 million. Two contracts were entered into the DRGR system but were not in the Housing Contract System and one contract was entered into the Housing Contract System but was not in DRGR. Overall, there was a total difference of \$2,313,071 more in the DRGR system than in the Housing Contract System.

HUD requires each grantee to report on its NSP funds using the DRGR system. HUD uses grantee reports to monitor for anomalies or performance problems that suggest fraud, waste, and abuse of funds and to reconcile budgets, obligations, fund draws, and expenditures.

A reconciliation of the data in the DRGR system, the Housing Contract System, and the contract file does not occur on a regular basis. Only two reconciliations were performed as of November 5, 2010. Both were performed in connection with an external audit by HUD. However, in both of these reconciliations, the data was not reconciled in the aggregate at the program level, only at the individual contract level. Without regular reconciliations, contract information in the Department's Housing Contract System will not be consistent with HUD's DRGR system or with the hard copy files.

The program manager is responsible for submitting program reports to HUD using the DRGR system. The program manager is also responsible for entering contract budget corrections into both DRGR and the Department's Housing Contract System. Ideally, these functions should be separated. When one person has the ability to enter data into the Housing Contract System and DRGR, there is a higher risk that data entry errors go undetected. Regular and routine reconciliations should identify data entry errors.

Lack of regular reconciliations may prevent management from having accurate performance information available for decision-making and for reporting to HUD. A regular reconciliation process ensures that data is accurate and that unauthorized changes have not occurred.

Recommendations

NSP should perform regular and routine reconciliations between the data in the Housing Contract System, the data in the DRGR system, and the hard copy files. At a minimum, these reconciliations should include:

- reviewing source documents,
- verifying the accuracy and recording of the transactions in the Housing Contract System,
- comparing DRGR to the Housing Contract System,
- identifying and resolving any discrepancies in a timely manner,
- documenting the performance of reconciliations,
- reviewing the reconciliations to ensure they are performed and any discrepancies are resolved, and
- ensuring the individual performing the reconciliation does not also enter data into either of the data systems being reconciled or have the ability to process transactions.

Management's Response

Management concurs. Program Services staff is currently in the process of reconciling the contract system with DRGR, and the responsibility for completing HUD reporting from the DRGR system is being reassigned to a staff member in Program Services. A full reconciliation is anticipated to be complete by April 30, 2011. Management will review existing draft SOPs to edit or create a new SOP to ensure that a process exists for the two systems to be reconciled on a monthly basis thereafter; associated SOPs will be finalized by May 30, 2011.

Chapter 2-B

Data in the Housing Contract System Should Accurately Reflect the Status of the Contracts

The contract status in the Housing Contract System does not always reflect the actual status of the contract. We randomly selected a sample of 48 NSP contracts for testing purposes. The status of 18 of the 48 (37.5%) contracts reviewed in the Housing Contract System (and using the hard copy contract files) was inaccurate. The status should be classified as "pending," "active," "closed," or "terminated for cause," depending on the situation.

We found that of the 18 inaccurately classified contracts:

- Ten contracts expired on November 30, 2010. According to NSP and TDRA management, amendments are in process. These contracts should be classified as "pending amendment" or "inactive" but were still labeled "active."
- Four files were labeled as "closed," but there was no formal documentation scanned in the Housing Contract System to support closing the project.
- Two files were labeled "terminated for cause" but should be "closed."
- One file labeled "active" should be "closed."
- One contract was not yet entered into the Housing Contract System; therefore, no status was available.

The status in the Housing Contract System should agree to the actual status of the contract. When triggering events such as contract expiration or contract termination occur, the status in the Housing Contract System should be revised and the correct classification should be used. Documentation supporting the triggering event should also be entered into the Housing Contract System.

NSP staff does not always update the Housing Contract System when triggering events occur such as contract expiration or voluntary termination. As a result, program managers who use the data in the contract file and the Housing Contract System for decision-making may not be relying on the correct data.

Recommendation

NSP should ensure that the contract status in the Housing Contract System accurately reflects the status of the contract.

Management's Response

Management concurs. Management will review and amend existing draft SOPs regarding contract status in the Housing Contract System to ensure that a clear procedure exists for timely and accurate updates to HCS and implement a monthly review as part of the monthly reconciliation process discussed as part of response to recommendation 2A.

Chapter 2-C

Supporting Documentation Needs to be Available in the Housing Contract System

Data in the Housing Contract System is often unavailable. Documents supporting the contract setups, draws, and the actual amendments themselves were not always present in the Housing Contract System. For instance, imaged documents for the budget amendments were not available in the Housing Contract System for 17 of 28 (60.7%) sub-recipient contracts reviewed. As a result, accounting and other program personnel periodically have to track down documentation supporting executed amendments on a case-by-case basis.

Supporting documentation for setups was not always available in the Housing Contract System. Examples of setup documents that were unavailable include:

- 26 of 48 files (54.2%) did not include evidence of environmental review, (of these 26 files, 21 were TDRA files), and
- 5 of 48 files (10.4%) did not include contract termination documents, although the contracts were (or should have been) terminated.

Draw documents not included in the Housing Contract System are discussed in Chapter 3-C.

The draft NSP procedures require that supporting documentation be entered into the Housing Contract System. Expecting program staff and other Department staff to track down documentation that should be available in the Housing Contract System is time consuming and inefficient. As a result, users of the Housing Contract System may rely on incorrect data because the information in the system is incomplete or unavailable.

Recommendation

NSP should:

- ensure that all supporting documentation is submitted by both the Department and TDRA and available in the Housing Contract System, and
- finalize, communicate, and enforce the procedures that require supporting documentation to be entered in the Housing Contract System.

Management's Response

Management concurs. Management will review and edit existing draft SOPs or create new SOPs to ensure that all required supporting documentation is submitted and available in the Housing Contract System. All checklists will be reviewed and edited, as necessary, to facilitate the

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process and provide a clear understanding of the required documentation. Associated SOPs and checklists will be finalized and communicated to staff and subgrantees by May 31, 2011.

Management will establish a process for periodic sampling and testing of the Housing Contract System by August 31, 2011 to ensure that all required supporting documentation is present.

Chapter 2-D

NSP Should Ensure that Supporting Documentation is Available to Verify that HUD Obligation Requirements were Satisfied

NSP does not maintain a listing, outside of the Housing Contract System, of the addresses and/or household names that were used to obligate the NSP funds by the September 3, 2010 deadline for obligations. NSP relies on the information in the Housing Contract System to record obligations. However, the Housing Contract System is constantly in flux and does not maintain a complete historical record of information. Therefore, we were unable to determine accurately the original population of awards obligated by the September 3, 2010 deadline. Because we could not determine the obligation population, we could not confirm compliance with the HUD requirements.

The Housing and Recovery Act of 2008 requires grantees to use NSP funds within 18 months of when HUD signed its NSP grant agreement. For the Department, the 18- month period ended September 3, 2010. Funds are considered used when they are obligated by a grantee. HUD requirements include ensuring each obligation can be linked to a specific address. The obligation for each eligible use must be further evidenced by a specific event. For example, acquisition and landbank costs are considered obligated when the seller has accepted the purchase offer. Demolition costs can be reported as obligated when the subgrantee awards a demolition contract. A subgrantee's rehabilitation costs can be recorded as obligated when a construction contract is awarded for a specific property. To test the evidence of obligation, the population of obligations must first be identified. Because a listing of addresses and/or household names was not maintained outside of the Housing Contract System, the population of obligations could not be easily determined.

Recommendation

NSP should ensure that the Department has documentation in place to support the obligation information reported to HUD.

Management's Response

Management concurs. Management has charged Program Services with the responsibility for re-evaluating and reconciling the documentation provided to recertify the obligations made as of the obligation deadline by April 30, 2011.

Chapter 2-E

Generic Data in the Housing Contract System Should be Replaced

Generic data is entered into the Housing Contract System in the household name field for NSP contracts. We tested 1,725 entries in the Housing Contract System and identified 1,188 (68.9%) with generic data in the household name field. Examples of generic data include: “unknown,” “not applicable,” “TBD,” or the street name.

The Housing Contract System requires an entry in the household name field in order for the entry to be completed. However, the NSP subgrantees do not always have this data available at the time of the data entry because the household name may not be determined until the completion of the project.

The Information Systems Division has scheduled modifications to the Housing Contract System that will allow a contract to be setup without using generic data. If the generic data that is entered into the Housing Contract System is not replaced with the actual data once it is known, then the data that is in the system will not be reliable. In addition, if the generic data is not standardized, then it will be difficult to identify all entries that have generic data in the household name field and will require a more in-depth analysis to ensure that all of the generic data has been replaced with the correct information once the system is modified.

Recommendations

NSP should ensure that:

- the generic data entered into the Housing Contract System is replaced by the correct data once it is known, and
- the subgrantees are consistent in the use of generic data entered into the household name field to ensure that all generic data can be identified and corrected.

Management's Response

Management concurs. After the field work for the audit was completed changes to the Housing Contract System were implemented to remove the requirement that generic data be entered in certain fields in order for the system to accept the activity setup. As the generic data fields all tie to homebuyer transactions, they will be corrected to include homebuyer information as the properties are resold. Training on both of these issues has also been provided to all subgrantees and the need for additional training will be monitored by the Program Specialist as they approve future activity set ups.

Chapter 3

The Draw Process Should be Improved

The draw process does not always support the payment of funds from the program. Draws submitted by TDRA are not reviewed by NSP staff prior to payment by the Department's Accounting Operations Division. The Memorandum of Understanding (MOU) between the Department and TDRA states that the Department is responsible for monitoring TDRA's oversight of their subgrantees and ensuring that funds are expended in accordance with the program requirements. This is important because TDRA is responsible for processing almost 20% of the NSP funding. NSP staff should review the TDRA draw requests prior to payment.

Draws are not always processed within the required five business days and the required supporting documentation is not always available in the Housing Contract System. We judgmentally selected 77 draws for testing purposes. Of the 77 draws tested, 18 (23.4%) were not processed within the five-day time frame; the longest delay was 42 days. Documents listed on the draw checklists and required for processing draws were not always found in the Housing Contract System. Examples of missing documents include: tax (payee) ID forms, comptroller letters, borrower authorization letters, evidence of single audit certificates, and payroll journals or cancelled checks to support the expenditures.

Draw checklists are not always used effectively. The draw request checklists need detail to guide subgrantees on how to submit draws and for NSP staff to use as criteria in processing draws. In addition, NSP does not have a checklist for every draw type, and staff does not use the checklists consistently nor sign the draw checklists as required. Without documented guidance in place, the subgrantees may not be aware of all requirements necessary for processing their draw requests. Similarly, without references in place, NSP staff responsible for processing draws may not have a firm knowledge of the items required to support the draw. As a result, there is a risk that NSP staff could approve draws for ineligible costs.

Chapter 3-A

The Department Should Review TDRA Draws Prior to Payment

Draws initiated by TDRA go directly to the Department's Accounting Operations staff for payment processing. NSP staff does not review these draws prior to payment. TDRA is responsible for the administration of no more than \$19,981,500 (19.6%) of the \$101,996,848 NSP grant from HUD.

The MOU between the Department and TDRA states that the Department will monitor TDRA's oversight of their subgrantees to ensure that activities are completed, performance goals are met, and funds are expended in accordance with program requirements, contract provisions, applicable state and federal rules, regulations, and policies.

Since the draws initiated by TDRA are not reviewed by NSP staff prior to payment, there is a higher risk that those draws may not be processed correctly or within the program's

requirements. The Department is responsible for the overall NSP grant from HUD, including the draws initiated by TDRA.

Recommendation

NSP should implement a monitoring process for all draws initiated by TDRA to ensure that the draws are processed correctly and within the program's requirements prior to payment by Accounting Operations staff.

Management's Response

Management concurs with the need for robust monitoring of TDRA, but the MOU with TDRA requires TDRA to have sufficient and appropriate controls for their draw process and holds them solely responsible for their draws. The Department's Compliance and Asset Oversight Division is scheduled to monitor TDRA and their subgrantee's NSP activities in March of 2011 and expect to have a report for management by the end of April. Management will ensure that the monitoring plan for TDRA's program contains a review of TDRA draws and will offer training and technical assistance to TDRA to address any deficiencies observed as part of the monitoring review.

Chapter 3-B

Timeliness of the Draw Process Should be Improved

Not all electronic draws are reviewed and approved or disapproved within five business days of submission as required by NSP's draft policies and procedures. We judgmentally selected 77 draws for testing purposes. Of the 77 draws we tested, 18 (23.4%) were not processed within five working days; the longest time delay was 42 working days. We tested closing fund draws, construction draws, activity delivery draws, set-up checklist draws, and draws for administrative expenses. These draws cover each of the five different eligible uses (financing mechanisms, acquisition and rehabilitation, land bank, demolition, and redevelopment) plus administrative expenditures.

- Of the 31 closing fund draws tested, six (19.4%) were processed after the five -day requirement, with eight days as the longest delay.
- Of the 5 construction draws tested, all were processed within the five-day requirement.
- Of the 13 activity delivery draws tested, one draw (7.7%) took an additional fourteen days to process.
- Of the 18 set-up checklist draws tested, seven (38.9%) were processed after the five-day requirement, with four days as the longest delay.
- Of the 10 administrative expenditure draws tested, four (40%) were processed after the five-day requirement with forty-two days as the longest delay.

Because the program uses a reimbursement basis, if draws are not processed in a timely manner, then subgrantees may not be able to meet their obligations.

Recommendation

NSP should ensure that all draws are processed within the required timeframe.

Management's Response

Management concurs that draws should be accurately and timely processed. Since the audit field work was completed, Management has re-assigned staff to improve the processing of draws. Management believes the revised process will ensure that the draws will be processed within the five days and will test to ensure that this is the case on a monthly basis, making additional adjustments to the process if needed.

Chapter 3-C

Draw Documentation in the Housing Contract System Should be Complete

The Housing Contract System is the automated system used by the Department to track housing activities. NSP uses the Housing Contract System to track the program's contracts, activities, and draws. We reviewed draw documents in the Housing Contract System to determine if all of the required documents were available and found that there were documents missing for three of the five types of draws we tested. We did not find any missing documents for set-up checklist draws or for construction activity draws.

Examples of missing documents include:

For the closing fund draws,

- 19 of 31 (61.3%) tax (payee) ID forms,
- 6 of 31 (19.4%) comptroller letters, and
- 5 of 31 (16.1%) borrower authorization letters were not on file.

For the activity delivery draws,

- 8 of the 13 (61.5%) draws tested did not have evidence of the single audit certificate.

For the administrative draws,

- 1 of the 7 (14.3%) administrative expenditure draws with salary costs did not provide either the payroll journals or cancelled checks to support the expenditures.

HUD requires that the Department maintain information on all draws, deposits and expenditures of grant funds. In addition, the NSP's draft procedure for draw requests requires that complete supporting documentation be received in order for a draw to be approved. Without the required supporting documentation, NSP does not have assurance that staff are processing draws accurately and within the program's requirements.

Recommendation

NSP should ensure that the required supporting documentation is available in the Housing Contract System prior to approving payment of the draw.

Management's Response

Management concurs that required supporting documentation should be attached to all draws prior to processing of payments. For TDHCA transactions two independent approvals (one by the NSP Program Specialist and one by the Quality Assurance Specialist in Program Services) of the supporting documentation are required for each draw. By August 31, 2011, the manager of NSP and the Director of Program Services will establish a process for periodic sampling and testing process of draws to ensure proper documentation has been included and to provide training for staff and subgrantees if such documentation is found to be missing.

Chapter 3-D

Draw Checklists Should be Used Effectively

The checklists used by NSP staff to process draw requests do not have enough detail to guide NSP staff on how to process these draws. There is not a checklist for every draw type, staff do not always use the checklists consistently, and the checklists are not always signed by staff. Use of NSP's draw request checklists could be improved to ensure they provide clear and detailed guidance to NSP team members. NSP developed checklists to guide subgrantees in submitting their draw requests and to serve as a reference for NSP staff as they process draws. The checklists are supposed to cite the required supporting documentation and list any verifications the NSP staff must make prior to approving a draw.

Draw request checklists need more detail to guide NSP staff on how to process draws. The draw request checklists do not outline the specific items that NSP staff should verify within the supporting documents. The checklists also do not reference the requirements or criteria against which the requests and support should be reviewed. For example, checklists include boxes that list verifications that the reviewer should perform, such as agreeing amounts with the Housing Contract System, but they do not provide guidance on the approved methodology for reviewing the listed supporting documentation. Reviewers are required to sign off to verify review of these documents. It is not clear if the reviewer's signature indicates verification of the existence of the documentation or of the adequacy of the documentation.

NSP needs a checklist for every draw type. NSP has four checklists in place to handle the six types of draws. Three draw types do not have specific checklists: demolition expense draws, purchase and rehabilitation draws, and land bank cost draws. For demolition draws, subgrantees typically submit either the Demolition Set-up Checklist or the Construction Draw Request Checklist. Depending on which checklist a subgrantee uses, the criteria used to submit and evaluate the draw will vary. As a result, subgrantees and NSP staff do not have clear guidance as to what documents and benchmarks are required for a demolition draw request to be accurately approved. However, the purchase and rehabilitation as well as the land bank draws can be covered by one of the existing checklists. Although it would be better for these draw types to have their own individualized checklist, the absence of one does not appear to be jeopardizing compliance or hindering operations.

NSP staff use either the Closing Fund Draw or the Set-up Checklist when processing a closing fund draw. NSP staff are not using the Closing Fund Draw Checklist to process all closing funds.

The Closing Fund Draw Checklist and the Set-up Checklist require different types of documentation to be provided in order for the draw to be processed. Therefore, the closing fund draws are not being processed consistently and the subgrantees may not have submitted all of the supporting documentation needed to process the draw. The draft NSP procedure related to draw requests states that the program specialist is responsible for ensuring that the supporting documentation is received as required by the appropriate draw request checklist.

Without documented guidance in place, the subgrantee may not be aware of all requirements necessary for their draw requests. Similarly, without references in place, NSP staff responsible for processing draws may not have a firm knowledge of the items required to support a draw. As a result, there is a risk that staff may approve draws for ineligible costs.

NSP and TDRA staff should complete the draw checklists consistently. Of the 77 judgmentally selected draws tested, 40 (51.9%) did not have completed checklists, and 16 (20.8%) checklists were not signed by the program specialist. The draft NSP procedure related to draws states that if the electronic setup is acceptable, then the program specialist will complete the draw request checklist. Without the signature of the program specialist affirming their review of the supporting documentation for the draw, NSP may be unable to determine if the supporting documentation was reviewed for accuracy and allowability prior to the approval of the draw by the program specialist. The use of checklists continually reminds staff of the job requirements. It is a systematic way to make sure the activities are completed correctly and provides written documentation to support this assertion.

Recommendations

NSP should improve the use of draw checklists by:

- modifying checklists to accurately document the draw requirements,
- developing comprehensive checklists for all draw request types, and
- ensuring that all draw checklists are completed correctly.

Management's Response

Management concurs. Management will re-evaluate and edit checklists as necessary to be specific for each of the following draw types: Administrative, Activity Delivery, Closing and Construction Draws.

The revised checklists will be implemented by March 31, 2011, and staff will continue to provide training and technical assistance to subgrantees in person and via webinar.

Chapter 4

The Department Should Increase Capacity to Handle Anticipated Loan Closings and Ensure the Accuracy of NSP Files

NSP management anticipates that the program will have to close approximately 400 loans between now and August 31, 2011. NSP has four staff for processing loan closings including two loan closing specialists, one of whom has additional duties. There are two other staff that can also close loans, but four loan closers is not sufficient to handle the anticipated workload. The large number of anticipated loan closings will also impact the Legal Division (legal), which prepares the loan documents for closing. Legal has anticipated this and is pursuing hiring outside counsel to assist in preparing loan documents. If these loans are not closed by the end of the contract period, HUD could potentially take recourse against the Department to recapture unused funds. In addition, delays could impact homeowners who are waiting to move into their homes. The Department should re-evaluate the loan closing workload and re-allocate staff as needed.

More than two-thirds of the files sent to legal by NSP are “rush” files. This means that they take priority over other files in legal’s queue. The changes in priority and the number of “rush files” occurs because subgrantees commit to deadlines without consulting the Department. As a result, NSP and legal are often rushing to meet deadlines they did not set. This process puts undue pressure on staff to complete work and increases the risk of errors or omissions. NSP should require subgrantees to communicate with the Department prior to setting deadlines.

NSP has been largely focused on productivity. High production appears to have impacted the quality of work. Consequently, the files that NSP sends to legal for loan document preparation are often incomplete. Of the 46 files currently in legal’s queue, seven (15.2%) had to be sent back because they were incomplete or required revisions or confirmations. The form that NSP uses for homebuyer loan files to ensure that all of the required documents are in the file before the file goes to legal is not comprehensive. Legal performs a review of the files when they receive them, but the responsibility for ensuring the accuracy of the information in the files lies with the NSP. Quality assurance reviews should be improved on the front end of the loan closing process to ensure that issues are caught and corrected before the files are sent to legal.

Chapter 4-A

The Department Needs Increased Resources to Meet the Deadline for Loan Closings

There are no formal timing requirements or goals in place for loan closing. Based on workload estimates provided by NSP management, there is not enough staff to close all the loans by the August 31, 2011 initial closing deadline.

NSP has four staff for loan closings. However two have additional responsibilities apart from closing loans. It is possible to process a homebuyer loan in 45 working days (or nine weeks) from underwriting to closure. This includes the 30 days required by legal for loan document preparation and review. In the private sector, it takes approximately two weeks to process a homebuyer loan and full-time loan processors can complete ten to fifteen closings each month. It

is important to note that non-homebuyer transactions can be more complex and may require more time and effort for the loan closer. To assess the feasibility of meeting the August 31, 2011 deadline, we considered different staffing scenarios for processing the estimated 400 loans and concluded that it is highly unlikely that NSP will be able to meet the deadline with the current staffing level. (See Table 1)

Scenario	# of Full-Time Closers	Estimated Workload Per Closer*	Difference from Estimated Workload Per Closer and Average Workload in Private Sector
1	2	400/2=200 total, 200/8=25 per month	25-12.5=+12.5
2	2.5	400/2.5=160 total, 160/8=20 per month	20-12.5=+7.5
3	3	400/3=133 total, 133/8=16 per month	16-12.5=+3.5
4	3.5	400/3.5=114 total, 114/8=14.25 per month	14.25-12.5=+1.75
5	4	400/4=100 total, 1 00/8=12.5 per month	12.5-12.5=0

*There are 400 files estimated to be closed, divided by the number of full-time closers, divided by eight months = the estimated workload per closer per month. (These estimates are as of January 2011.)

Table 1

The average workload used for comparison purposes in Table 1 is the average estimated workload for private sector loan closings. Assuming that the private sector processes loans at a faster rate (two weeks), and comparing this rate to the Department's minimum nine-week process, the feasibility of NSP meeting the deadline at their current staffing level is further diminished. In addition, given other demands on the loan closers' time, it is very unlikely that NSP will have three to four closers working on loans full-time until August 31st. Finally, since the loan closers cannot begin the closing process until the subgrantees have submitted a setup, it is unlikely that the anticipated workload will be evenly distributed over the coming months. It is more likely that as the deadline approaches more and more setups will be submitted for processing, creating longer delays and a larger backlog.

If NSP is unable to close the estimated number of loans by August 31, 2011, homebuyers awaiting closings could be without housing or incur additional expense in finding a temporary place to live.

Recommendation

The Department should re-evaluate the resources of the NSP and reallocate staff as necessary to ensure that there are an adequate number of loan closers to complete the anticipated influx of closings. In addition, NSP should redistribute responsibilities to ensure that employees who conduct homebuyer loan closings can focus primarily on that task.

Management's Response

Management concurs and has re-allocated staff resources in order to ensure that homebuyer transactions are processed timely. Management will monitor workflow and as bottlenecks are forecast and identified, adjust resources to focus on the portion of the closing effort that is affected.

Chapter 4-B

The Workload for the Legal Division's Loan Document Preparation Is Challenging

To ensure NSP's priorities are met, staff from legal created a tracking sheet of all files in its queue, which is updated regularly to reflect NSP's changes. The tracking sheet indicates that the queue has more than twice the number of "rush files" as it does files that are "pushed back" to allow for rushed jobs. Seven of the 46 files listed in legal's queue (15.2%) include comments stating that they were returned to NSP for revisions or confirmations. In many cases, legal had already started work on the files when they had to be returned.

In mid-December, legal released a Memorandum of Understanding (MOU) between NSP staff and legal staff regarding loan file workflows. The MOU requires program staff to meet with legal staff on a weekly basis to coordinate reasonable workloads, prioritizations, and projected work volumes. However, priority changes within NSP are occurring on a daily, rather than weekly basis.

The changes in priority and the number of "rush files" occurs because subgrantees commit to move-in dates and deadlines with prospective homebuyers without consulting the Department. As a result, NSP and legal are often rushing to meet deadlines they did not set. Legal is pursuing outside counsel to assist with the loan document preparation for approximately 400 incoming loans. Therefore, legal's workload will likely change once the outside counsel is hired.

The unreasonable workload could result in missing deadlines, a diminished quality of work, excessive overtime, a high burn-out rate, and the potential loss of experienced staff in both NSP and legal.

Recommendations

NSP should require subgrantees to communicate with the Department prior to setting deadlines for move-in with homebuyers. Move-in dates should be set after the loan documents are completed and ready for closing. In addition, NSP should take full ownership of reorganizing files to its preferred order for legal processing, thus alleviating the current back-and-forth between the two areas and freeing up the legal staff to focus on the preparation of loan documents.

Management's Response

Management agrees and is in the process of clarifying the responsibilities of program staff, Program Services staff, and Legal Services to promote efficiency, avoid duplicative efforts, and improve the coordination and scheduling of loan closings. As noted in the response to 1-D, subrecipient training and additional resources have been established to increase the communication surrounding loan closings. These actions will ensure a more predictable workflow and closing timeline. Legal Services, NSP, and Financial Administration are also assessing the possibility of adding to the Legal Services staff within existing budgetary and FTE constraints. Additionally, management is concluding a procurement process to secure an outside law firm to assist in preparing closing documents for homebuyer transactions under NSP.

Chapter 4-C

NSP Loan Files Provided to Legal Should be Complete and Accurate

Key support, such as contracts and environmental clearance certifications, are often missing from the loan files when NSP forwards the files to legal. NSP Loan Closing Specialists attach a "Request for Preparation of Loan Documents and Closing Instructions" form to loan files provided to legal. The form provides general information on the files' contents. We compared the NSP form to the documentation that legal needs for homebuyer loan preparation. The form did not include many of the items needed by legal, including subgrantee contract information, indication of environmental clearance, and indication that the purchase discount was satisfied or waived.

NSP has been largely focused on productivity. High production appears to have an impact on the quality of work. The risk of error is heightened by the lack of mitigating controls such as formalized policies and procedures (see Chapter 1-C.)

The responsibility for ensuring the accuracy of the information in the files lies with the NSP. If information in the loan file is not correct and the error is not caught by legal, inaccurate or incomplete homebuyer loans could be closed and funded, NSP money could fund non-compliant transactions, or NSP may unknowingly report incorrect information to HUD.

Recommendations

NSP should:

- enhance quality assurance reviews on the front end of the homebuyer loan closing process to ensure that issues are caught and corrected before files are sent to legal, and
- amend the "Request for Preparation of Loan Documents and Closing Instructions" form to include a comments section and checkboxes to indicate the file includes all of the items required by legal in order to prepare homebuyer loan documents.

Management's Response

Management concurs. Management will ensure the standardization of documentation to be reviewed by Legal Services and existing checklists will be reevaluated and revised in

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coordination with Legal Services to ensure that files are complete for each transaction. The clarifications now being finalized will clearly delineate the documents that will be required (to enable subgrantees to gather them), the review to be performed by Legal Services, and the programmatic reviews that will be performed by NSP and/or Program Services.

Chapter 5

HUD Program Requirements, NOFA Requirements and Contract Requirements Should be Consistently Followed

The NSP is not consistently following HUD's program requirements or the requirements set out in the Department's Notice of Funding Availability (NOFA.) NSP did not submit an annual Section 3 Report for 2009 as required by HUD. Section 3 requires the Department and its subgrantees to give priority to low and very low-income people in the community when awarding opportunities for jobs, training, or contracts using HUD funds.

The Department's NOFA set a minimum award amount of \$525,000 (including the administrative costs). Of the 48 randomly selected draws tested, one original contract was written for less than \$525,000. In addition, the NSP contract between the Department and its subgrantees requires that both parties to the contract agree in writing to its termination. There was one contract we identified in which the subgrantees requested to terminate the contract, but NSP management did not confirm the contract termination in writing as required by the contract. Consequently, this contract has not been officially terminated.

Chapter 5-A

The 2009 Annual Section 3 Summary Report Should be Submitted to HUD

NSP did not collect Section 3 data for 2009. Section 3 of the Housing and Urban Development Act of 1968 requires the Department and its subgrantees to give priority consideration in awarding jobs, training, and contracting opportunities to low- and very low-income persons who live in the community in which the funds are spent. NSP contracts have been in place since September 1, 2009, but Subrecipient Activity Reports used to collect Section 3 data were not modified to capture the required data until March 31, 2010.

We tested 23 randomly selected Subrecipient Activity Reports submitted since April 2010 and found that only 12 (52.2%) of the reports submitted by the subgrantees in our sample used the revised reporting template designed to capture the required Section 3 reporting data. Of those 12, only six subgrantees reported any Section 3 data.

HUD's guidance on Section 3 reporting says, "State and county agencies must report to HUD on the cumulative Section 3 activities within their jurisdiction on an annual basis.... Section 3 reports must be submitted by all agencies that receive Community Planning and Development funding in excess of \$200,000 whether the requirements were triggered or not." According to the guidance, the Department should have submitted an annual Section 3 Summary Report for 2009 even though there were no Section 3 activities performed by the subgrantees during 2009. Failure to comply with the requirements of Section 3 may result in sanctions including debarment, suspension, or limited denial of participation in HUD programs.

Recommendation

NSP should submit Section 3 Summary Reports to HUD in accordance with HUD's guidance in order to ensure that the Department complies with federal program requirements.

Management's Response

Management concurs. The Program Services Division is coordinating with the Housing Resource Center to prepare the 2009 and 2010 Section 3 report for the Department. The Department established a Board policy on Section 3 in December of 2010 and immediately thereafter launched a website to inform and collect information for all Section 3 impacted programs. NSP subgrantees have been informed via a listserv announcement of the new website and the policy which reiterated requirements already in their contracts.

Chapter 5-B

The Department Should have Followed the \$525,000 Minimum Award Amount

Although not required by HUD, the Department's NOFA set a minimum NSP contract amount of \$500,000 plus \$25,000 in administration fees for a total contract of \$525,000. However, of the 48 randomly selected contract files tested, one original contract was written for less than \$525,000. The NSP NOFA states that "In order to avoid allocating small amounts of funding that can have no meaningful impact on stabilizing of property values, the minimum award amount to an eligible entity cannot be less than \$500,000, excluding administration cost."

Although the Texas Administrative Code for NSP allows the Department to issue a waiver of certain contract terms required in the 2009 NSP NOFA, the stricter requirements of the NOFA may have deterred potential subgrantees from applying for grant funds and could have resulted in fewer areas served by the NSP.

Recommendation

The Department should abide by the NOFA to ensure the subgrantees understand the Department's intent and that all subgrantees are offered an equal opportunity to participate under the same set of rules.

Management's Response

Management concurs and will ensure that any future subgrantee abides by the requirements of the applicable NOFA.

Chapter 5-C

NSP Should Confirm Contract Terminations in Writing

NSP management did not consistently abide by the contract terms for termination of a contract. Specifically, a subgrantee requested that its NSP contract with the Department be terminated but the Department failed to issue a letter confirming the termination as required by the contract.

An Audit of the Neighborhood Stabilization Program

The contract between TDHCA and each subgrantee indicates that, "either of the parties to this contract shall have the right to terminate this contract when both parties agree that the continuation of the activities funded under this contract would not produce beneficial results commensurate with the further expenditure of funds; provided that both parties agree, in writing, upon the termination conditions, including the effective date of such termination."

NSP management acknowledged termination of the contract via a phone call, but did not ensure that the required letter was sent in order to complete the termination process. As a result, the termination process for this contract is not complete.

Recommendation

The Department should abide by the contract terms and confirm the termination of any NSP contract in writing.

Management's Response

Management agrees and will review all contract files to ensure that all contracts administered by TDHCA requiring termination have been documented in writing as terminated by March 31, 2011.

Appendix A

Objectives, Scope and Methodology

Objectives

The overall objective of the audit was to determine whether the Department's Neighborhood Stabilization Program (NSP) is operating effectively and in compliance with laws, regulations, and program requirements.

Scope

The scope of the audit was the Department's administration of NSP1 funds from September 1, 2009 through November 15, 2010.

Methodology

We gained an understanding of the Department's process for administering the NSP through interviews with key team members and management, attendance at subgrantee training sessions and roundtables, observation of operations, and review of background information. We assessed the Department's policies and procedures in relation to federal and state laws, rules, and guidance. We evaluated internal controls and developed procedures to determine their effectiveness.

To answer the detailed objectives of our audit, we performed the following audit work:

- We tested subgrantee setups in the Housing Contract System to ensure they were processed correctly, in a timely manner, with adequate supporting documentation, and in compliance with program rules and regulations. We tested subgrantee draws in the Housing Contract System to ensure they were processed correctly, in a timely manner, with adequate supporting documentation, and in compliance with program rules and regulations.
- We assessed the amendment review and formalization process, and performed testing within the Housing Contract System to determine whether documentation supporting the execution of budget amendments was maintained and accessible.
- We reviewed NSP's standard operating procedures to determine whether program staff had access to sufficient guidance to carry out their duties consistently and effectively.
- We tested monthly activity reports submitted by subgrantees to determine whether they included Section 3 data as required by HUD. In addition, we compared Section 3 subgrantee training attendance sheets to the list of subgrantees to determine whether all subgrantees received the required training.

An Audit of the Neighborhood Stabilization Program

- We reconciled overall contract amounts in the Disaster Recovery Grant Reporting (DRGR) system with totals in the Housing Contract System to ensure that data used for operations and reported to HUD was complete and accurate.
- We conducted in-depth interviews and reviewed tools, guidance, and MOUs to identify and assess controls over the homebuyer loan closing process.
- We followed up on the areas of concern identified in the HUD monitoring report. We determined whether any funds were disbursed for construction-related activities at select sites and, if so, obtained supporting documentation to determine whether federal procurement requirements were met.

Limitations

We attempted to test the quality of obligation data originally provided to HUD for the September 3, 2010 deadline. However, due to the dynamic nature of the Housing Contract System, we were unable to obtain a historical snapshot of obligations at that point in time.

Criteria

We used the following documents as criteria:

- Texas Administrative Code, Title 10: Community Development, Part I: Texas Department of Housing and Community Affairs, Chapter 9: Texas Neighborhood Stabilization Program
- Federal Register, Vol. 73, No. 194 dated Monday, October 6, 2008
- U.S. Department of Housing and Urban Development Guide to Neighborhood Stabilization Program (NSP) Eligible Uses
- Funding Approval and Grant Agreement for Neighborhood Stabilization Program (NSP) Funds as Authorized and Appropriated under the Housing and Economic Recovery Act of 2008 (Public Law 110-289, July 30, 2008)
- United States General Accounting Office, Standards for Internal Control in the Federal Government, dated November 1999
- MOU between Texas Department of Housing and Community Affairs and Texas Department of Rural Affairs
- The Department's general and NSP-specific Standard Operating Procedures
- The Department's NSP Homebuyer Financing Guidelines, Technical Guide, checklists, and other internally-developed tools and guidance
- Contractual agreement between the Department and the NSP subgrantees
- Substantial Amendment to State of Texas 2008 CDBG Action Plan for NSP
- Update to the Substantial Amendment dated February 25, 2010

Type of Audit

This audit was a performance audit of the Neighborhood Stabilization Program.

Report Distribution

As required by the Texas Internal Auditing Act (Texas Government Code, Chapter 2102), this report is being distributed to the:

- Texas Department of Housing and Community Affairs' Governing Board
- Governor's Office of Budget and Planning
- Legislative Budget Board
- State Auditor's Office
- Sunset Advisory Commission

Project Information

Audit fieldwork was conducted from November 8, 2010 through January 21, 2011. The audit was conducted in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing.

The following staff performed this audit:

Betsy Schwing, CPA, CFE, Project Manager
Nicole Elizondo, CFE, CICA
Harriet Fortson, MAcy, CGAP, CICA, CCA
Derrick Miller
Kari Reitan
Rene Valadez, CIA

Appreciation to Staff

We would like to extend our sincere appreciation to management and staff of the Neighborhood Stabilization Program and the Legal Division for their cooperation and assistance during the course of this audit.

Appendix B

Background

The Neighborhood Stabilization Program (NSP) is a HUD-funded program authorized by the *Housing and Economic Recovery Act of 2008* (HERA). NSP provides funds to purchase foreclosed or abandoned homes and to rehabilitate, resell, or redevelop these homes in order to stabilize neighborhoods and stem the decline in value of neighboring homes. NSP funds may be used for activities which include, but are not limited to:

- establishing financing mechanisms for purchase and redevelopment of foreclosed homes and residential properties,
- purchasing and rehabilitating homes and residential properties abandoned or foreclosed,
- establishing land banks for foreclosed homes,
- demolishing blighted structures, and
- redeveloping demolished or vacant properties.

NSP grantees must use at least 25% of the funds appropriated for the purchase and redevelopment of abandoned or foreclosed homes or residential properties that will be used to house individuals or families whose incomes do not exceed 50% of the area median income. In addition, all activities funded by NSP must benefit low- and moderate-income persons whose income does not exceed 120% of area median income.

Grantees have 18 months from the date HUD signed their grant agreements to obligate these funds and four years to expend an amount equal to these allocations. HUD expects that grantees will have signed contracts or, at a minimum, made written offers for properties within 18 months. Options or other non-binding instruments are not acceptable.

NSP grantees may use up to 10% of their allocations for administrative and planning costs. In addition, up to 10% of the program income generated from NSP-funded activities may be used for administrative and planning costs. For all grantees including states, the 10% limitation applies to the grant as a whole.

The following table shows the budgets and disbursements for the NSP program to date.

Eligible Use	Budget (from Substantial Amendment)	Activity Disbursements (from DRGR)	Activity Disbursements as a Percentage of Budget
Financing Mechanisms	\$18,297,163	182,354	1%
Acquisition and Rehabilitation	\$44,000,000	18,665,302	42%
Land Bank	\$9,500,000	4,711,741	50%
Demolition	\$6,000,000	482,313	8%
Redevelopment	\$14,000,000	547,132	4%
Administration	\$10,199,685	2,471,687	24%
	\$101,996,848	27,060,529	27%

Source: DRGR as of 1/27/2011 and the 2/25/10 Update to the Substantial Amendment

Table 2



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

www.tdhca.state.tx.us

Rick Perry
GOVERNOR

Michael Gerber
EXECUTIVE DIRECTOR

BOARD MEMBERS
C. Kent Conine, *Chair*
Tom H. Gann, *Vice Chair*
Leslie Bingham Escareño
Lowell A. Keig
Juan S. Muñoz, Ph.D.
J. Paul Oxcr

April 12, 2011

To: The Governing Board and Audit Committee Members of the Texas Department of Housing and Community Affairs

Re: Internal Audit Report on the Weatherization Assistance Program

Attached is the internal audit report on the Texas Department of Housing and Community Affairs' (Department's) Weatherization Assistance Program (WAP). WAP has effective procedures in place to predict, identify, and prevent program weaknesses at the subrecipient level. However, WAP should further strengthen and formalize the processes it uses to prevent, detect, or identify fraud, waste, or abuse. Although the monitoring instrument used by the program officers is comprehensive and effective, there are opportunities for enhancement in the monitoring procedures. In addition, WAP needs a centralized location to document and track complaints as well as fraud, waste, or abuse allegations. It is important that information on complaints and fraud, waste, or abuse allegations is maintained in a centralized location to ensure that they are resolved in accordance with the Department's policies.

As part of this audit, we followed up on and cleared all eight prior audit issues identified in previous internal audits as well as four issues identified during the Department of Energy's previous monitoring visits.

Our audit objectives were to determine how the WAP predicts, identifies, and prevents weaknesses at the subrecipient level; to determine how WAP prevents and detects fraud, waste or abuse in its program; and to determine how WAP complaints are tracked, followed-up on, and resolved.

This audit was conducted in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing.

If you have any questions about this audit, please contact me at (512) 475-3813. We appreciate the assistance and cooperation we received from the management and staff of the program.

Sincerely,

A handwritten signature in black ink that reads "Sandra Q. Donoho".

Sandra Q. Donoho, MPA, CISA, CIA, CFE, CICA
Director of Internal Audit

Encl. (1)

cc: Michael Gerber, Executive Director
Tim Irvine, General Counsel and Chief of Staff
Brooke Boston, Deputy Executive Director for Community Based Programs
Michael De Young, Director, Community Affairs

Executive Summary

The Texas Department of Housing and Community Affairs (Department) Weatherization Assistance Program (WAP) has effective procedures in place to predict, identify, and prevent program weaknesses at the subrecipient level. The Energy Assistance section (EA) of the Community Affairs Division (Division) performs subrecipient monitoring for the WAP and uses a monitoring instrument to perform and document the results of their monitoring. The monitoring instrument and monitoring procedures are designed to identify problems at the subrecipient level. In addition, the WAP staff has implemented the recommendations from our April 2010 audit of the monitoring program.

An analysis of available WAP monitoring reports for program years 2008, 2009, 2010, and ARRA funds showed that the most common types of monitoring findings were deficiencies in client files and inadequate record keeping. In addition, for the program years reviewed, the program officers identified \$410,886 in questioned costs and \$173,775 in disallowed costs during these monitoring visits. Although the monitoring instrument used by the program officers is comprehensive and effective, there are opportunities for enhancement in the monitoring procedures. For example, selecting a sample from the entire program year instead of just the previous three months, and identifying and reviewing client files for all subrecipient employees who received WAP services.

The WAP does not have formalized procedures in place regarding the prevention and detection of fraud, waste, or abuse. In addition, the WAP does not have a centralized location to track or document the status, action taken, or outcome of fraud, waste, or abuse allegations and investigations. It is important that fraud, waste, or abuse allegations received by WAP be maintained in a centralized location to ensure that all allegations are tracked, investigated, and resolved as appropriate.

There is also no formalized process in place for WAP complaint tracking, investigation, escalation, or resolution. In addition, the WAP does not maintain complaint information in a centralized location. It is important that complaint information be maintained in a centralized location in order to ensure that all complaints are tracked, investigated, and resolved in accordance with the Department's policies.

Other Key Points

- As part of our audit work, we were able to clear and close all eight prior internal audit issues from previous audits of the WAP (#69, 139, 140, 141, 142, 143, 144, 145 and 146).
- We were also able to clear all four Department of Energy prior external monitoring issues.

Summary of Recommendations

- EA should consider expanding its monitoring procedures to include the following
 - request, review, and select a sample from the entire general ledger for the program year under review,
 - identify subrecipient employees who have received weatherization services and review those client files to ensure that eligibility and prioritization was determined in accordance with DOE guidelines, and
 - gain a sufficient understanding of the subrecipients' processes through staff and contractor interviews, identify key controls, and ensure those controls are in place and working as intended.

- The Division should develop, finalize, and distribute strengthened procedures for the prevention and detection of fraud, waste, or abuse, including a process for tracking, investigating and resolving any allegations brought directly to the program officers or Division management. In addition, the Division should establish a centralized location to track all WAP fraud, waste, or abuse allegations.

- The Division should develop and implement enhanced procedures for subrecipient education regarding fraud, waste, or abuse prevention and detection.

- The Division should develop, finalize, and distribute procedures for the tracking, investigation, and resolution of complaints and establish a centralized location to track all complaints received by the program officers or Division management, including information regarding the investigation and resolution of the complaint.

Summary of Management Responses

Management is in agreement with the results of the audit and is making changes as described in the detailed responses to each chapter.

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Detailed Results

Chapter 1

Monitoring Procedures Predict, Identify, and Prevent Weaknesses at the Subrecipient Level

The Energy Assistance section (EA) of the Community Affairs Division (Division) performs subrecipient monitoring for the Weatherization Assistance Program (WAP). The EA has effective monitoring procedures in place to predict, identify, and prevent weaknesses at the subrecipient level. EA program officers use a monitoring instrument to perform and document their monitoring. The monitoring instrument provides the program officers with a list of the procedures they should perform during the financial, administrative, and unit inspection portions of their monitoring visit.

The procedures outlined in the monitoring instrument are designed to identify areas of weaknesses at the subrecipient level. However, although the monitoring instrument is comprehensive and effective, there are opportunities for enhancement in the procedures to help ensure that problems are identified and addressed before they escalate. These opportunities include requesting and reviewing the general ledger for the entire year, identifying and reviewing the client files for subrecipient employees who receive WAP services and reviewing the internal controls (such as policies or procedures) used by the subrecipients to manage their WAP processes.

An analysis of available WAP monitoring reports for program years 2008, 2009, 2010, and ARRA funds was performed to identify the various types of findings in these reports as well as the total amount of questioned and disallowed costs. The most common types of findings were deficiencies in client files and inadequate record keeping. In addition, for the program years reviewed, the program officers identified \$410,886 in questioned costs and \$173,775 in disallowed costs during these monitoring visits. See Table 1 below for a breakout of the questioned and disallowed costs by program.

WAP Monitoring Results		
Program	Questioned Costs	Disallowed Costs
WAP 2008	\$0	\$20,242.52
WAP 2009	\$219,838.20	\$126,406.20
WAP 2010	\$22,447.31	\$0
WAP ARRA	\$168,600.35	\$27,126.71
Total	\$410,885.86	\$173,775.43

Table 1

We also performed a financial and administrative review at three subrecipient sites. As part of this review, we performed additional and expanded procedures based on the procedures in the monitoring instrument. Although the monitoring instrument is comprehensive, there are opportunities for enhancement in the procedures.

The monitoring instrument requires the program officers to review two months of expenditures, cash disbursement journals, and supporting documentation. The program officers request the subrecipient's general ledger for two months, select a sample of expenditures, and review the supporting documentation for those expenditures. We expanded this procedure to include a review of the entire general ledger for the WAP to date. After a review of the general ledger at one subrecipient, we determined that the beginning and ending balances from one month to the next did not always match and that there were significant journal entries used to transfer funds from one funding source to another. A review of two months of expenditures is a limited picture of the general ledger. Consequently, it would be beneficial for the program officers to perform a review of the entire general ledger to date (at the time of their monitoring). This will allow the program officers to identify trends or unusual transactions from which to base their sample and to request supporting documentation.

In addition, we compared a list of the subrecipient's employees' names and addresses with the names and addresses of the clients who received weatherization services. At one subrecipient, there were eight (1.8%) address matches with the 451 completed units. At another subrecipient, there were three (0.6%) address matches with the 508 completed units. Although subrecipients may have employees who meet the WAP eligibility requirements, it is important to ensure that they received services in accordance with the Department of Energy's (DOE) guidelines. Therefore, it would be beneficial for the program officers to identify subrecipient employees who have received weatherization services and to perform a review of the employees' client files to ensure that the eligibility and prioritization was correctly determined.

We also interviewed subrecipient staff and contractors to identify the processes used in the management of the WAP. We used the processes identified to determine the internal controls in these processes (such as policies and procedures) and performed tests of those controls to determine if the internal controls were working as intended. At one subrecipient, we noted that a contractor responsible for assessments was unable to describe the process used to assess a home for weatherization. In addition, subrecipients were requesting additional documentation from clients that is not required by DOE WAP guidelines. Finally, in testing internal controls, we identified instances where subrecipients were not always following their own procedures. As a result, it would be beneficial for program officers to interview staff and contractors in order to determine the processes they use and to identify the internal controls in place. This will allow the program officers to ensure that the processes documented in the subrecipients' policies and procedures are the processes actually used by the subrecipients' employees and that the internal controls are working as intended.

Recommendations

EA should consider expanding their WAP monitoring procedures to include the following:

An Internal Audit of the Weatherization Assistance Program

- request, review, and select a sample from the entire general ledger for the program year under review,
- identify subrecipient employees who received weatherization services and review those client files to ensure that eligibility and prioritization was determined in accordance with DOE guidelines, and
- gain a sufficient understanding of the subrecipients' processes through staff and contractor interviews to identify internal controls, and ensure those controls are in place and are working as intended.

Management's Response

Community Affairs Management agrees with the recommendations to modify the WAP monitoring procedures to include a sample from the entire General Ledger for the program year. Program officers will look for unusual trends or transactions that warrant further inspection or require clarification. Management also concurs with the identification and increased scrutiny on subrecipient employees that receive weatherization services. Staff will request and review each of the files in order to ensure that proper documentation was received, and proper procedures were followed in accordance with the DOE guidelines and Texas Administrative Code requirements. Management also recognizes the value of staff interviews to identify internal controls and to validate the effectiveness of the internal controls and will strive to integrate those into current processes.

The Project Manager for Monitoring will update the monitoring instrument to reflect the revised procedures and provide instructions to the monitors on how to implement properly the new procedures for General Ledger request and review. This target date for implementation is May 1, 2011.

Chapter 2

A Formal Process is Needed to Prevent, Detect, and Track Fraud, Waste, or Abuse

Although many of the monitoring procedures are designed to identify potential instances of fraud, waste, or abuse, the WAP does not have formalized procedures in place regarding the prevention and detection of fraud, waste, or abuse. In addition, there is no centralized location to track or document the status, action taken, or outcome of fraud, waste, or abuse allegations and investigations. Centralized tracking of fraud, waste or abuse allegations is important in order to provide comprehensive information to management and to identify trends at the subrecipient level that could indicate a need for additional monitoring or training.

A survey of the Department's program officers and unit inspectors indicated that the procedures used by the program officers to detect and prevent fraud, waste, or abuse vary. The wide range of responses suggests that specific fraud, waste, or abuse detection procedures have not been effectively communicated to the program officers. In addition, it suggests that the WAP does not have clear procedures for subrecipient fraud, waste, or abuse education or prevention.

We performed a review of the monitoring instrument used by program officers during full on-site monitoring visits of WAP subrecipients to determine the existence and the sufficiency of procedures intended to prevent, detect, and deter fraud, waste, or abuse. The monitoring instrument contains the following sections: financial review, travel and timesheets, general liability and pollution occurrence insurance, property management, procurement, audit, personnel policies and practices, performance review on-site inspections, administrative (energy audits), client file review, multifamily review, and denied file review. The program officers are also required to review prior monitoring visit results and to bring forward any repeat issues that they identify.

Many of the procedures contained in the monitoring instrument are designed to identify potential instances of fraud, waste, or abuse. For example, the monitoring instrument requires the program officer to ensure that the subrecipients' contracts with their sub-contractors have a provision in place regarding the prevention of fraud, waste, or abuse. It also requires the program officer to ensure that the subrecipient has a policy in place to establish, maintain, and utilize an internal control system sufficient to prevent, detect, and correct incidents of fraud, waste, or abuse. In addition, the monitoring instrument requires the program officers to confirm that the agency posted notice of the rights and

Definitions

(From the Department's Policy on Fraud, Waste and Abuse)

Fraud – Any intentional act or omission designed to deceive, resulting in a loss to an individual or entity and a gain for the perpetrator.

Waste – The intentional or unintentional, thoughtless or careless expenditure, consumption, mismanagement, use, or squandering of resources.

Abuse – Intentional destruction, diversion, manipulation, misapplication, maltreatment, or misuse of resources.

remedies afforded whistleblowers under Section 1553 of the American Recovery and Reinvestment Act of 2009.

However, when we conducted a survey of the Department's WAP program officers and unit inspectors with specific questions related to procedures for the detection and prevention of fraud, waste, or abuse, the respondents' answers varied widely. The responses for detection fell into one of the following general categories: by following the monitoring instrument, by performing comparisons and reconciliations, through conversations with subrecipient staff, and by identifying and testing anomalies and/or perceived weaknesses. The wide variation between responses suggests that specific detection procedures should be more effectively communicated to the program officers or unit inspectors.

When asked about procedures for preventing fraud, waste, or abuse, most program officers and unit inspectors cited the various monitoring procedures they mentioned previously regarding detection. Few program officers or unit inspectors addressed how they prevent fraud, waste or abuse from occurring in the first place. Therefore, the results suggest that the WAP does not have clear procedures for subrecipient education or prevention.

In addition, the WAP does not have a centralized location to track or document the status, action taken, or outcome of fraud, waste, or abuse allegations and investigations. We requested all information related to fraud, waste, or abuse allegations for program years 2008- present and obtained a list of investigation documentation from WAP management. WAP management noted that it does not maintain fraud, waste, or abuse documentation in a centralized location. It is important that fraud, waste, or abuse allegations received by WAP be maintained in a centralized location to ensure that all allegations are tracked, investigated, and resolved as appropriate. In addition, these allegations should be shared with the appropriate Department staff as required by the Department's policy.

Recommendations

The Division should:

- develop, finalize, and distribute strengthened procedures for the prevention and detection of fraud, waste, or abuse including a process for tracking, investigating, and resolving any allegations brought directly to the program officers or Division management
- develop and implement enhanced procedures for subrecipient education regarding fraud, waste or abuse prevention and detection, and
- establish a centralized location to track all WAP fraud, waste, or abuse allegations.

Management's Response

Management agrees with the recommendations and will develop expanded procedures for the prevention and detection of fraud, waste, and abuse, including development of a centralized process for tracking investigations and the documentation of the resolution of identified instances. The database will reside in an agency drive with "read only" access for all Community Affairs staff and will be editable by limited staff in order for management to ensure, timely, thorough and proper documentation and subsequent resolution of identified instances.

The Office of ARRA Accountability and Oversight has already developed, finalized and distributed the procedures for subrecipient education regarding fraud, waste, and abuse. These documents were provided to the subrecipient network on April 4, 2011.

Chapter 3

A Formal Process is Needed to Track, Investigate and Resolve Complaints

The WAP does not have a formalized process in place for complaint tracking, investigation, escalation, or resolution. In addition, the WAP does not maintain complaint information in a centralized location. Tracking complaints and maintaining them in a central location is important in order to identify trends that could indicate potential fraud, waste, or abuse, or a need for additional monitoring or training of subrecipients.

There is a variety of ways that a complaint can be brought to the attention of the WAP staff, including legislative inquiries, the Department's fraud, waste, or abuse hotline, the Department's online complaint system, referrals from the DOE; and through Department staff. When a complaint is received, WAP management will assign the complaint to one of the WAP program officers for follow-up. Documentation of the complaint is the responsibility of the program officer who was assigned to the complaint.

We conducted a survey of the 18 WAP program officers and unit inspectors with specific questions related to complaint tracking and resolution. We received 14 responses. Most respondents stated that they receive complaints "sometimes" to "regularly." However, the procedures for tracking, investigating and resolving complaints varied among the respondents.

The survey results indicate a clear complaint escalation process is not in place. When asked, "Who do you notify when you receive a WAP related complaint?" Six of the 14 respondents (43%) stated that their approach to handling the complaint depends on the complaint type. For example, sometimes the respondent will notify management of the complaint and sometimes they handle the complaint independently. Four respondents (29%) stated that they notify management for every complaint received and two respondents (14%) said management notifies them of complaints. One respondent (7%) stated that he/she typically notifies the program officer who is assigned to the subrecipient indicated in the complaint. One respondent (7%) did not answer this question.

Similarly, a wide range of survey responses indicates that a clear complaint tracking process is not in place. When asked, "How do you track complaints?" Six of the 14 respondents (43%) stated they do not track complaints and the remaining five (36%) cited a range of methods including personal calendars, e-mail, notes to self, and a phone contact log.

A set complaint investigation approach or timeframe also appears to be lacking. When asked, "How do you follow-up on and resolve complaints?" of the 14 respondents, six (43%) stated they typically resolve complaints in 0-5 days, three (21%) stated they take 6-10 days, two (14%) said they take 11-15 days, and two (14%) said they take 16-20

days. Their methods for resolving complaints ranged from phone calls to verifications to written responses.

The WAP does not maintain complaint information in a centralized location. We attempted to perform a review of all WAP complaints for program years 2008 to present. However, WAP management was unable to provide a complete population of the complaints because they are documented in various locations and often in individuals' e-mail. The WAP should track all complaint information in a centralized location in order to ensure that all complaints are tracked, investigated, and resolved.

Recommendation

The Division should develop, finalize, and distribute procedures for the tracking, investigation, and resolution of complaints and establish a centralized location to track all complaints received by the program officers or Division management, including information regarding the investigation and resolution of the complaint.

Management's Response

Management agrees with the recommendations and will develop procedures for the tracking, investigation and resolution of complaints including development of a centralized process for tracking investigations and the documentation of the resolution of complaints. The database will reside in an agency drive with "read only" access for all Community Affairs staff and will be editable by limited staff in order for management to ensure, timely, thorough and proper documentation and subsequent resolution of identified instances.

The Manager of the Energy Assistance Section will develop procedures for the tracking, investigation and resolution of complaints. Additionally, the Manager of Energy Assistance will initiate a centralized tracking system for all complaints. The target date for implementation is May 1, 2011.

Chapter 4

Prior Audit Issues

PAI #	Source	Description of Issue	Description of Corrective Action Taken	Status
69	Internal Audit Report #1012	The management information system does not have data fields to capture significant milestones related to the delivery of the monitoring letter and receipt of subrecipients' responses to follow-up letters. In addition, the system does not consistently capture clear and complete details on the results of monitoring activities such as findings, conditions noted, required corrective actions, concerns, and comments.	TDHCA developed and implemented a comprehensive WAP Monitoring Results Tracking Tool to track the results of each monitoring visit. Tracked fields include sub-recipient name, monitoring lead, visit type, visit dates, key due dates, unit inspection data, findings, recommended actions, and notes. For findings, the tool also tracks the responsible party, due date, sub-recipient responses, corrective actions taken, and final resolution.	Cleared
139	Internal Audit Report #10-1035	TDHCA guidelines, which required monitoring reports to be issued within 45 days of a monitoring visit, were inconsistent with the DOE, which requires reports be issued within 30 days of a monitoring visit.	TDHCA updated its WAP monitoring guidelines for compliance with the DOE guidance.	Cleared

An Internal Audit of the Weatherization Assistance Program

PAI #	Source	Description of Issue	Description of Corrective Action Taken	Status
140	Internal Audit Report #10-1035	We noted that the population of units inspected during monitoring visits did not necessarily include units weatherized at the end of the program year (because they were not yet complete).	TDHCA's WAP Monitoring Guidelines, dated January 1, 2011, instruct program officers to select a representative sample for unit inspections from all units completed since the last monitoring cut-off date.	Cleared
141	Internal Audit Report #10-1035	EA program officers have a combination of programmatic and monitoring responsibilities that could potentially impair their independence and effectiveness.	TDHCA's WAP Monitoring Guidelines, dated January 1, 2011, state, "It is a policy of the Energy Assistance (EA) Section that a program officer assigned to provide on-going technical and programmatic guidance to a sub-recipient cannot lead or participate in a monitoring visit of that same sub-recipient."	Cleared
142	Internal Audit Report #10-1035	TDHCA does not have a set training curriculum for EA program officers.	Effective January 1, 2011, TDHCA set a required training curriculum for new program officers to include courses in weatherization orientation, lead renovation, basic weatherization, advanced weatherization, and NEAT-MHEA weatherization.	Cleared

An Internal Audit of the Weatherization Assistance Program

PAI #	Source	Description of Issue	Description of Corrective Action Taken	Status
143	Internal Audit Report #10-1035	The Monitoring Guide was in draft form and had not been reviewed, approved or distributed.	WAP management reviewed, approved, and distributed the WAP Monitoring Guidelines.	Cleared
144	Internal Audit Report #10-1035	The standard operating procedure (SOP) for labor standards related to the American Recovery and Reinvestment Act (ARRA) and WAP was not finalized or approved by management.	Program Services finalized the SOP and communicated its contents to staff.	Cleared
145	Internal Audit Report #10-1035	TDHCA's monitor tracking system did not include all DOE-recommended elements (findings, recommended corrective actions, deliverables, due dates, responsible parties, actions taken, and final resolutions).	TDHCA developed and implemented a WAP Monitoring Results Tracking Tool that includes all of the DOE-recommended elements.	Cleared
NA	DOE Monitoring Report - 9/27 On-Site Visit at Sub-Recipient, Community Services Inc., Corsicana, Texas.	DOE noted that the sub-recipient was improperly using the energy audit to analyze and rank allowable measures, as required by the Texas State Plan. DOE requested that TDHCA verify that the EZ-2 audit is run properly until the NEAT audit is implemented.	In a letter dated March 3, 2011, DOE provided a monitoring visit report that stated the prior finding has been resolved to its satisfaction.	Cleared

An Internal Audit of the Weatherization Assistance Program

PAI #	Source	Description of Issue	Description of Corrective Action Taken	Status
NA	DOE Monitoring Report - 9/27 On-Site Visit at Community Services Inc.	DOE found that the sub-recipient paid a contractor for a window that was not installed. DOE considered this payment to be fraudulent. DOE required TDHCA to investigate the matter and provide evidence that associated costs were disallowed and reimbursed.	In a letter dated March 3, 2011, DOE provided a monitoring visit report that stated the prior finding has been resolved to its satisfaction.	Cleared
NA	DOE Monitoring Report – 11/15 On-Site Visit at Travis County Health and Human Services and Austin Energy	DOE found that the subrecipients ran the NEAT audit improperly. DOE requested that TDHCA provide an action plan and timeline to correct the misuse of the audit tool.	In a letter dated March 3, 2011, DOE provided a monitoring visit report that stated the prior finding has been resolved to its satisfaction.	Cleared
NA	DOE Monitoring Report – 11/15 On-Site Visit at Travis County Health and Human Services and Austin Energy	DOE noted an instance of inappropriate billing to the program. DOE required TDHCA to submit an action plan and timeline to correct the action and reimburse the program.	In a letter dated March 3, 2011, DOE provided a monitoring visit report that stated the prior finding has been resolved to its satisfaction.	Cleared

Appendix A

Objectives, Scope and Methodology

Objectives

- Determine how the Weatherization Assistance Program (WAP) predicts, identifies, and prevents weaknesses at the subrecipient level.
- Determine how complaints in the Weatherization Assistance Program (WAP) are tracked, followed-up on, and resolved.
- Determine how the Weatherization Assistance Program (WAP) prevents and detects fraud, waste, or abuse in its program.

Scope

- Weatherization Assistance Program contracts for program years 2008, 2009, 2010.
- American Recovery and Reinvestment Act (ARRA) Weatherization Assistance Program contracts for the period beginning September 2009.

Methodology

We evaluated how the WAP predicts, identifies, and prevents weaknesses at the subrecipient level. Specifically:

- We performed a financial and programmatic review of select subrecipients utilizing the monitoring instrument as a starting point.
- We performed interviews to determine the process for predicting, identifying, and preventing weaknesses at the subrecipient level.
- We performed an analysis of prior monitoring reports to determine if there are any patterns of findings related to administrative or financial practices among the subrecipients.
- We performed an analysis of prior monitoring reports to determine the amount of questioned/disallowed costs that have been identified by the program officers during their monitoring visits.
- We performed an analysis of prior monitoring reports to determine if findings were treated consistently among the reports.
- We conducted a survey of the program officers and unit inspectors to determine if there were any findings that were removed from the monitoring report at the request of WAP management.
- We performed an analysis of the sanction process and how it is applied to the subrecipients.

We evaluated how complaints in the WAP are tracked, followed-up on, and resolved. Specifically:

An Internal Audit of the Weatherization Assistance Program

- We conducted interviews to determine the process for how complaints are tracked, followed-up on, and resolved.
- We requested all complaints received for the scope of the audit and perform an analysis of how they were identified, tracked, followed-up on and resolved.
- We performed an analysis of the sanction process and how it is applied to the subrecipients.

We evaluated how the WAP prevents and detects fraud, waste, or abuse in its program. Specifically:

- We conducted interviews to determine the process for preventing and detecting fraud, waste, or abuse in WAP.
- We reviewed any tools used by WAP in the prevention and detection of fraud, waste, or abuse.
- We requested a list of all fraud, waste, or abuse allegations received and performed an analysis of how they were identified, tracked, followed-up on, and resolved.
- We performed an analysis of the sanction process and how it is applied to the subrecipients.

As part of the audit, we followed up on prior audit issues related to the Weatherization Assistance Program.

We used the following documents as criteria:

- Texas Department of Housing and Community Affairs Standard Operating Procedures 1100.01, Section 1.3 and 2.2
- Texas Department of Housing and Community Affairs Standard Operating Procedures 1200.10, Section 2.1 and 2.2
- WAP monitoring instrument
- Policies and Procedures from the subrecipients reviewed
- Texas Department of Housing and Community Affairs Recommended Practice on Fraud, Waste, and Abuse
- Texas Department of Housing and Community Affairs Fraud, Waste, Abuse, and Suspected Criminal Activity memo

Type of Audit

This was a performance audit of the Weatherization Assistance Program's monitoring, complaint, and fraud, waste, or abuse processes.

Report Distribution

As required by the Texas Internal Auditing Act (Texas Government Code, Chapter 2102), this report is distributed to:

Texas Department of Housing and Community Affairs – Internal Audit Division
April 2011

Report # 11-1041

An Internal Audit of the Weatherization Assistance Program

- The Texas Department of Housing and Community Affairs' Governing Board
- The Governor's Office of Budget and Planning
- The Legislative Budget Board
- The State Auditor's Office
- The Sunset Advisory Commission

Project Information

Audit fieldwork was conducted from January 31, 2011 through March 25, 2011. This audit was conducted in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing.

The following staff performed this audit:

Nicole Elizondo, CFE, CICA, Audit Project Manager
Rene Valadez, CIA
Kari Reitan

Appreciation to Staff

We would like to extend our sincere appreciation to management and staff of the Energy Assistance Program section of the Community Affairs Division for their cooperation and assistance during the course of this audit.

Appendix B

Background

The Weatherization Assistance Program (WAP) is designed to reduce energy costs for low-income families, particularly for the elderly, people with disabilities, and children, by improving the energy efficiency of their homes while ensuring their health and safety.

The Texas Department of Housing and Community Affairs (TDHCA) is responsible for administering WAP with funds from the US Department of Energy (DOE), Low Income Home Energy Assistance Program (LIHEAP) and Investor Owned Utility Program funds.

WAP is administered through 33 subrecipients (Community Action Agencies, units of local governments, and other nonprofits), which collectively cover all 254 counties of the state. In addition, in FY 2009 WAP expanded to include 13 additional subrecipients (cities) due to the increase of funding related to the American Recovery and Reinvestment Act (ARRA).

The subrecipients have the option of using the Priority List, which is a set list of energy measures that can be applied to a unit based off the geographic zone the unit is in, or they can perform an energy audit of each unit which identifies the areas in the unit where air leaks may be occurring.

The energy audit provides a whole-house approach which aims to maximize energy and dollar savings. In order for the weatherization materials to be installed they must meet specific energy-savings goals as identified in the energy audit.

Typically, weatherization work consists of the following:

- Caulking
- Weather-stripping
- Adding ceiling, floor, and wall insulation
- Patching holes in the building envelope
- Performing duct work
- Tune-up, repair or replacement of energy inefficient heating and cooling systems

In addition, the energy audit will also look at any appliances in the unit to determine any inefficiency.

TDHCA is responsible for ensuring that the subrecipients are administering the program in accordance with their contract and associated federal and state laws and regulations. This is done through the Community Affairs Division's Energy Assistance Program (EA) section. As part of the monitoring process, EA is responsible for performing desk-reviews and on-site monitoring of each subrecipient administering WAP.



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

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April 20, 2011

To: The Governing Board and Audit Committee Members of the Texas Department of Housing and Community Affairs

Re: Internal Audit Report on the Tax Credit Assistance Program

Attached is the internal audit report on the Texas Department of Housing and Community Affairs' (Department's) Tax Credit Assistance Program (TCAP.) The Department correctly awarded \$148.4 million in funds to eligible tax credit projects as required by the U. S. Department of Housing and Urban Development (HUD.) We reviewed the application and scoring process used by the Department to award TCAP funds as well as the contracts and amendments for the 60 TCAP projects that received awards and found no errors. One of these projects was later terminated, which resulted in 59 developments funded by TCAP.

The Department paid draws (requests for payment) for expenses associated with TCAP projects in accordance with the program's requirements, the Department's procedures, and applicable laws and regulations. We tested a sample of 30 draws and found that all of them were processed correctly and that payments were only made for eligible expenses.

The Department met all of the TCAP reporting requirements and is providing HUD with accurate, complete, and timely data. The Department met HUD's requirement to award at least 75% of the \$148.4 million it received in TCAP funds and to commit at least 75% of these funds by the end of the first year. HUD also required the Department to spend at least 75% of the TCAP funds it received by February 16, 2011. The Department expended \$121.7 Million (82%) of the funds by this deadline. The Department is on track to spend all of the TCAP funds by February 16, 2012 as required by HUD.

Because there were no findings in this report, management responses were not required and are not included. This audit was conducted in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing.

If you have any questions about this audit, please contact me at (512) 475-3813. We appreciate the assistance and cooperation we received from the management and staff of the program.

Sincerely,

A handwritten signature in black ink, appearing to read "Sandra Q. Donoho". The signature is fluid and cursive, with the first name being the most prominent.

Sandra Q. Donoho, MPA, CISA, CIA, CFE, CICA
Director of Internal Audit

Encl. (1)

cc: Michael Gerber, Executive Director
Tim Irvine, General Counsel and Chief of Staff
Tom Gouris, Deputy Executive Director for Housing Programs
Jeannie Arellano, Director of the HOME Program

Executive Summary

The Texas Department of Housing and Community Affairs' (Department) Tax Credit Assistance Program (TCAP) correctly awarded \$148.4 million in funds to eligible tax credit projects as required by the U. S. Department of Housing and Urban Development (HUD) rules for TCAP. The Department provided 60 low-income housing tax credit projects with TCAP funds but one of these projects was later terminated. We reviewed the application process used to award TCAP funds and compared it to the HUD requirements as well as to the Department's TCAP rules. We found that all of the projects that received funding met HUD's and the Department's requirements for a TCAP award. The Department competitively awarded TCAP funds using four different application rounds, with each having its own unique eligibility rules. In addition, the Department developed a scoring system for applications and used a checklist to ensure that each application met the eligibility requirements. We tested the contracts and amendments for all of the TCAP projects and found no errors.

The Department paid draws (a draw is a request for payment) for expenses associated with TCAP projects in accordance with the program's requirements, the Department's procedures, and applicable laws and regulations. We tested a sample of 30 draws and found that all of them were processed correctly and that payments were only made for eligible expenses. The Department has a process in place to provide two levels of review for draws, as well as checklists to ensure that the correct documentation is obtained to support the payment of the draw.

The Department met all of the TCAP reporting requirements and is providing HUD with accurate, complete, and timely data. HUD's annual reporting requirements for TCAP were designed to ensure that the program is completed within the required three years. The Department met HUD's requirement to award at least 75% of the \$148.4 million it received in TCAP funds and to commit at least 75% of these funds by the end of the first year. HUD also required the Department to spend at least 75% of the TCAP funds it received by February 16, 2011. The Department expended \$121.7 Million (82%) of the funds by this deadline. The Department also successfully committed all of the TCAP grant funds (100%) by the end of the second year. The Department is on track to spend all of the TCAP funds by the end of the third year (February 16, 2012) as required by HUD.

The Tax Credit Assistance Program (TCAP)

TCAP is a three-year program under HUD's HOME Investment Partnerships Program (HOME). Its purpose is to provide funds for capital investments in multi-family projects that received low-income housing tax credit awards between October 1, 2006 and September 30, 2009. TCAP is funded by the American Recovery and Reinvestment Act (ARRA.)

(See Appendix B for additional TCAP eligibility requirements.)

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Chapter 1

The Department Awarded All Tax Credit Assistance Program Funds to Eligible Properties

The Texas Department of Housing and Community Affairs (Department) correctly awarded all Tax Credit Assistance Program (TCAP) funds to eligible low-income housing tax credit projects, as required by the Department and the U.S. Department of Housing and Urban Development (HUD.) The Department received an allocation of \$148.4 million in TCAP funds in July 2009. The Department committed funds to 60 projects, but one of these was subsequently terminated for cause. The American Recovery and Reinvestment Act of 2009 (ARRA) which funds TCAP, limits TCAP awards to those projects that received an award of tax credits between October 1st, 2006 and September 30th, 2009 . All TCAP contracts and amendments also complied with the requirements established by the Department and by HUD. We tested the applications for all projects that received commitments and reviewed the contracts and amendments associated with these projects and did not find any errors.

The application process used by the Department ensured that all TCAP applicants were eligible to receive funding and that all applications met the Department's and HUD's requirements. We reviewed the application process for TCAP and verified that all of the necessary requirements of the Department and of HUD were included in the application. The application review process was thorough and was consistently applied to each applicant.

The Department conducted four application rounds to competitively award TCAP funds, each with unique eligibility rules. (See Appendix C) In addition, the Department established a scoring system for applications and used a checklist to ensure that each application met the eligibility requirements. The applications were reviewed and independently scored by two staff in order to identify any deficiencies, such as missing documents. Applicants were notified of deficiencies in their application and were allowed to correct them. In addition, the application review process included an updated feasibility analysis from the Department's underwriting section. The results from each application round were then forwarded to the Department's governing board for final approval.

We tested each of the applications to determine if all eligibility requirements were met prior to the applicant receiving TCAP funds. Our testing included:

- verifying a tax credit award between October 1st, 2006 and September 30th, 2009,
- confirming that the property had an environmental clearance on file,
- determining that the project developer was not in material non-compliance for any other Department programs,
- verifying that a new underwriting report was completed and that the amount recommended in the underwriting report matched the amount of the TCAP award, and
- confirming that each checklist was completed and signed by the reviewers.

Chapter 2

The Department Processed and Paid Draws in Compliance with TCAP Requirements

The Department paid draws for eligible TCAP expenses in accordance with the program requirements, the Department's procedures, and applicable laws and regulations. We tested 30 TCAP draws and found no errors. The process in place to review and approve draw requests is thorough and multiple reviews ensure that expenses are eligible for payment using TCAP funds. For example, TCAP funds can only be used for capital investment in low-income housing tax credit properties. Funds can be used for new construction or to rehabilitate a property. TCAP funds may also be used for land purchase, demolition, and hazardous materials remediation. However, TCAP funds may not be used for administrative costs or for asset management of TCAP properties. (See Appendix B for additional requirements.)

The TCAP draw process ensures that TCAP projects are only paid for eligible expenses. A draw is a request for payment. The project developer requests payment by providing supporting documentation for the amount requested. The documentation is reviewed by program staff and, if sufficient, is approved for payment. A second review is provided by a member of the quality assurance team. Both reviewers sign off on review checklists and approve the draw in the Housing Contract System. TCAP personnel are knowledgeable about processing TCAP draws. In addition, there is effective communication between TCAP personnel and consistency in the processing of TCAP transactions.

To verify that draws were processed properly and expenditures were made only for TCAP eligible expenses, we judgmentally selected the final draws for five completed projects and a random sample of 25 other draws. The random sample included draws for 25%, 50%, 75% and 100% of the award amounts. We reviewed the documentation and the completed checklists for each of the draws. For draws of 50% and greater, we verified that the project construction was 50% complete within 12 months of the loan closing date. We verified that expenditures were TCAP eligible and were properly documented. We confirmed that the checklists were completed and signed. All 30 of the draws we reviewed were processed correctly.

Chapter 3

The Department Met HUD's Timelines for Awarding and Spending TCAP Funds and Provides HUD with Accurate, Complete and Timely TCAP Data

The Department met all of the TCAP reporting requirements we reviewed and is providing HUD with accurate, complete, and timely data. HUD's annual reporting requirements for TCAP were designed to ensure that the program is completed within the required three years. TCAP was created on February 17, 2009. In the first year, the Department met HUD's requirement to award at least 75% of the \$148.4 million it received in TCAP funds and to commit at least 75% of these funds. In the second year, HUD required the Department to spend at least 75% of the TCAP funds it received by February 16, 2011. The Department expended \$121.7 Million (82%) of the funds by the 75% deadline. Furthermore, the Department successfully committed all of the TCAP grant funds (100%) by the end of the second year. The Department is on track to spend all of the TCAP funds by the end of the third year (February 16, 2012) as required by HUD. (See Table 1)

To ensure that TCAP reporting was accurate, we compared the annual TCAP reports that the Department submitted to HUD via HUD's Integrated Disbursement and Information System (IDIS) with data in the Department's Housing Contract System as of February 16, 2011, which was the last day of the second year of TCAP. We found that the information provided to HUD was accurate and complete and that it matched the data in the Housing Contract System. The Department regularly reconciles the TCAP data reported to HUD in IDIS with the data in the Housing Contract System in order to ensure the accuracy and completeness of the information. A formal reconciliation is prepared at the end of each calendar quarter and forwarded to management for review. We also observed an informal review, which occurs after each TCAP transaction is recorded. HUD relies on the information in IDIS to determine the progress of the TCAP program, so it is essential that the data entered into IDIS is accurate and complete.

TCAP Program Year	Milestone	Department Performance
Year 1	Award 75% of TCAP Funds	Awarded over 75%
Year 1	Commit 75% of TCAP Funds	Committed 78.5%
Year 2	Commit 100% of TCAP Funds	Committed 100%
Year 2	Spend 75% of TCAP Funds	Spent 82%
Source: HUD CPD Notice 09-03 "Implementation of the Tax Credit Assistance Program" (milestones) and IDIS reports on 2-16-10 and 2-16-11 (performance)		

Table 1

To verify that at least 75% of TCAP funds were awarded and committed through contracts by the end of the first year, we reviewed documentation from HUD acknowledging the Department's success in meeting these goals. We also requested a report from IDIS at the end of the second year to confirm that all TCAP funds were awarded. In addition, we compared the activity in the Department's Housing Contract System with the HUD IDIS reports and confirmed the contract

An Internal Audit Report on the Tax Credit Assistance Program

awards reported to HUD for both years were complete and accurate. We also found that the Department submitted all required TCAP reports on a timely basis.

The Department successfully paid draws for eligible expenses that totaled 82% of TCAP funds before the end of the second year. We compared the TCAP draws recorded in the Housing Contract System with the amount reported in IDIS as of February 16, 2011 to confirm the total amount of these draws. We also reviewed a sample of these draws for accuracy and completeness and found no errors. (See Chapter 2)

Appendix A

Objectives, Scope and Methodology

Objectives

To determine if:

- the Department awarded TCAP contracts and amendments in accordance with HUD's and the Department's TCAP requirements,
- draws are processed in compliance with key program requirements, relevant procedures, laws, and regulations, and
- TCAP data reported to HUD is accurate, complete and timely.

Scope

- The scope of the audit was from February 17, 2009 (the date of the enactment of the American Recovery and Reinvestment Act of 2009) to February 16, 2011, a period of two years.
- We did not perform audit work on the Integrated Disbursement and Information System, which is HUD's automated system and is used to track projects, including TCAP.
- We did not perform audit work on the Department's Housing Contract System because it was evaluated by KPMG in 2009 as part of the annual Statewide Audit and no issues were identified.

Methodology

The methodology consisted of gaining an understanding of the application, award, and draw processes for administering TCAP by reviewing background materials, policies and procedures, TCAP documents, federal laws, regulations, financial data, application review tools and checklists, and interviews with staff and division management. Understanding of the reporting process was gained through interviews with HOME and TCAP staff, and Financial Administration staff having direct involvement in the TCAP program, and analysis of the reported TCAP activity.

We reviewed the following documents:

- HOME Standard Operating Procedures (SOPs):
 - SOP for Multi-family Set-up Requests
 - SOP for Multi-family Draw Requests
 - SOP for Application Intake and Awards
 - Draft SOP for TCAP Electronic Application Intake and Awards
 - SOP for Multifamily Project Completion Reports IDIS Closeout
 - SOP for Contract Generation
- Checklists and Review Sheets:
 - TCAP Activity Set-up Checklist
 - TCAP Draw Disbursement Checklist
 - TCAP Loan Closing Due Diligence Checklist

An Internal Audit Report on the Tax Credit Assistance Program

- 2009 TCAP Application Threshold & Selection Review Sheet
- 2009 TCAP Application Threshold Review Sheet Round 2
- 2009 TCAP Application Threshold Review Sheet Round 3
- 2009 TCAP Application Threshold Review Sheet Round 4
- Previous Participation Review of TCAP Applications Memo
- 2010 Enterprise Risk Management self-assessment for HOME
- Expenditure Revenue and Budget Information:
 - TCAP Population of Grantees by Contract Number and Amount
 - IDIS status report of TCAP as of 1-11-2011
 - HUD table of grantee states' expenditures as of 1-30-2011
 - HUD IDIS Contract Commitment Report 2-16-2010
 - Financial Administration IDIS report reconciliation
 - Housing Contract System - TCAP Program Fund Summary

We used the following documents as criteria:

- American Recovery and Reinvestment Act of 2009
- Internal Revenue Code of 1986, 26 USC 42
- HUD Community Planning and Development Notice 09-03
- HUD Community Planning and Development TCAP Grant Agreement Guidance
- HUD Community Planning and Development TCAP Written Agreement Guidance
- HUD Community Planning and Development TCAP IDIS Guidance
- The Department's Legal Determination on TCAP by General Counsel
- Tax Credit Assistance Program Submission Packet (as revised 7-16-09)
- Multifamily and HOME Divisions, American Recovery and Reinvestment Act of 2009 Tax Credit Assistance Program (TCAP) Policy through Board Resolution No. 09-043
- Supplemental Information to the Board Policy on American Recovery and Reinvestment Act of 2009, Tax Credit Assistance Program
- Funding Approval and Tax Credit Assistance Program (TCAP) Agreement dated 7/23/2009
- TCAP Round Three Policy (March 2010)
- TCAP Round Four Policy (July 2010)
- 2007 Housing Tax Credit Program, Qualified Allocation Plan and Rules
- 2008 Housing Tax Credit Program, Qualified Allocation Plan and Rules
- 2009 Housing Tax Credit Program, Qualified Allocation Plan and Rules

To answer the detailed objectives of our audit, we performed the following audit work:

- We compared overall contract amounts in HUD's IDIS with the contracts recorded in the Housing Contract System to ensure that the total Department grant award was distributed to TCAP projects.
- We tested the application and award process to ensure that applications were processed correctly, in a timely manner, with supporting documentation, in compliance with HUD and the Department's program requirements, and awards were made to eligible applicants.

An Internal Audit Report on the Tax Credit Assistance Program

- We tested a combined judgmental and random sample of TCAP draws to ensure that the draws were for eligible expenditures and were completed in accordance with key program requirements, relevant procedures, and laws and regulations.
- We reviewed and reconciled TCAP data in the Department's Housing Contract System with HUD's IDIS milestone reports to determine the accuracy and timeliness of reporting contract commitments and expenditures.

Type of Audit

This audit was a performance audit of the Tax Credit Assistance Program.

Report Distribution

As required by the Texas Internal Auditing Act (Texas Government Code, Chapter 2102), this report is distributed to the:

- Texas Department of Housing and Community Affairs' Governing Board
- Governor's Office of Budget and Planning
- Legislative Budget Board
- State Auditor's Office
- Sunset Advisory Commission

Project Information

Audit fieldwork was conducted from February 25 through March 18, 2011. The audit was performed in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing.

The following staff performed this audit:

Harriet Fortson, M.Acy, CGAP, CICA, CCA, (Project Manager)
Derrick Miller
Kari Reitan
Betsy Schwing, CPA, CFE

Appreciation to Staff

We would like to extend our sincere appreciation to management and staff of the HOME division, and especially the staff of the Tax Credit Assistance Program for their cooperation and assistance during the course of this audit.

An Internal Audit Report on the Tax Credit Assistance Program

Appendix B

Background

The Tax Credit Assistance Program (TCAP) was established by the American Recovery and Reinvestment Act (ARRA) on February 17, 2009. TCAP is funded through the HOME Investment Partnerships Program (HOME) and is administered by the U.S. Department of Housing and Urban Development (HUD). ARRA allocated \$2.25 billion to the states based on the percentage of HOME funds allotted to each state for fiscal year 2008. The state of Texas received \$148.4 million. All of the TCAP funds must be spent by February 16, 2012.

The purpose of TCAP is to provide funding to compensate for the current devaluation of housing tax credits to properties that were awarded low-income housing tax credits in federal fiscal years 2007, 2008 and 2009. (see text box)

Housing developments requesting TCAP awards must meet the following federal eligibility requirements:

- Projects were previously awarded tax credits during the period from October 1, 2006 through September 30, 2009.
- Projects must continue to hold some tax credits. (Some credits may be returned, but a minimal amount must be retained.)
- Projects must meet the housing tax credits' use, income and rent restrictions. Projects are limited to new construction or rehabilitation/reconstruction of rental properties affordable to households earning up to 60% of the Area Median Family Income (AMFI), as determined by HUD.
- States must administer TCAP in accordance with Low Income Housing Tax Credit rules and limitations, with the exception of certain HOME program regulations that apply with respect to compliance with the Davis-Bacon Act (labor standards) and environmental requirements.

The Department must use a competitive selection process to award TCAP funds to tax credits development projects based on the selection criteria in the Qualified Allocation Plan (QAP). ARRA requires that the Department give priority to projects that are expected to be completed by February 16, 2012. The Department developed the following additional eligibility requirements:

- Projects receiving funds must continue to meet the threshold and scoring requirements as included in the original application or the most recent amendment approved by the Board.

Texas Department of Housing and Community Affairs – Internal Audit Division
April 2011

Report # 11-1042

<p style="text-align: center;">The Housing Tax Credit Program</p> <p>Through the Housing Tax Credit Program, the federal government encourages private investment in affordable rental housing by providing investors a dollar-for-dollar reduction on their federal tax liability for every dollar of eligible construction expenses.</p> <p>The current economic crisis has decreased demand for tax credits by investors. As a result, the pricing of tax credits has plummeted, and many approved developments now lack the total funding needed for completion.</p> <p>Source: TDHCA's website</p>
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An Internal Audit Report on the Tax Credit Assistance Program

- The development project may not be in “material noncompliance” with any program within the Department.
- Projects requesting funds must provide evidence of a good faith effort to obtain equity commitments.

Other requirements for the administration of the TCAP program include:

- States are responsible for asset management, either directly or through contracting, of TCAP properties, but they cannot use TCAP funds to fulfill asset management responsibilities.
- TCAP funds may not be used for swimming pools.
- From the date of enactment of ARRA, states must:
 - commit at least 75% of funds within 1 year,
 - demonstrate that property owners expended 75% of allocated funds within two years, and
 - expend 100% of allocated funds within three years.
- The Department set a requirement that projects requesting draws of 50% or more must complete 50% of the construction within 12 months of the loan closing date.

An Internal Audit Report on the Tax Credit Assistance Program

Appendix C

The Department's Unique TCAP Requirements by Application Round

Application Round	Specific Requirements	TCAP Funds Awarded
Round 1	<ul style="list-style-type: none"> • Restricted to low-income housing tax credit recipients for award years 2007 or 2008 	\$66,578,847
Round 2	<ul style="list-style-type: none"> • Restricted to low-income housing tax credit recipients for award year 2009 	\$58,703,353
Round 3	<ul style="list-style-type: none"> • Restricted to low-income housing tax credit recipients not awarded TCAP in prior rounds and • Have not submitted a cost certification to the Department 	\$14,124,613
Round 4	Open to any project which <ul style="list-style-type: none"> • Received TCAP award from any prior round or • Has not received a TCAP award but otherwise program eligible with an environmental clearance, or • Has substantially completed construction but has not submitted IRS Form 8609. 	\$ 8,947,956
	Total Awarded	\$148,354,769

**INTERNAL AUDIT DIVISION
BOARD REPORT ITEM
MAY 5, 2011**

Presentation and discussion of the status of external audits.

Recommend Action

No action required; information only.

Background

There are thirteen external audits, reviews or monitoring visits for fiscal year 2011 that are either planned, underway or were recently completed. Of these:

- Nine are complete and the reports released,
- Three are complete but reports have not yet been received, and
- One (a HUD review of the Homeless Prevention and Rapid Re-housing Program) will start in July.

**TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
INTERNAL AUDIT DIVISION – STATUS OF FY 2011 EXTERNAL AUDITS
May, 2011**

External Audits/Activities	Scope/Description	Stage	Comments
KPMG	The scope of the financial portion of the Statewide Single Audit includes an audit of the state’s basic financial statements for fiscal year 2010 and a review of significant controls over financial reporting and compliance with applicable requirements.	Completed	Report released in March 2011.
Deloitte and Touche	Annual opinion audits: <ul style="list-style-type: none"> • Basic Financial Statements for the FYE August 31, 2010. • Revenue Bond Program Audit for the FYE August 31, 2010. • FY 2010 Unencumbered Fund Balances. 	Completed	Report released in December 2010.
HUD-OIG	To determine whether the Department monitored the program management firm (ACS) to ensure compliance with federal and state requirements and if ACS has properly supported costs submitted for reimbursement.	Completed	Report released in January 2011.
DOE	The DOE reviewed weatherization activities as part of their quarterly monitoring.	Completed	Report released in November 2010.
DOE	The DOE reviewed weatherization activities as part of their quarterly monitoring.	Completed	Report released in December 2010.
DOE	The DOE reviewed weatherization activities as part of their quarterly monitoring.	Completed	Report released in March 2011.
HUD	HUD provided technical assistance and reviewed files for rent reasonableness in the Section 8 program’s SAFMR demonstration project.	Completed	No report is anticipated.

**TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
INTERNAL AUDIT DIVISION – STATUS OF FY 2011 EXTERNAL AUDITS
May, 2011**

External Audits/Activities	Scope/Description	Stage	Comments
NeighborWorks	Monitoring and compliance review of the National Foreclosure Mitigation Counseling Program.	Completed	Report released in March 2011.
Treasury	An on-site compliance review of the Section 1602 program (Housing Tax Credit Exchange Program).	Completed	The Treasury conducted this monitoring visit September 8-9, 2010. No report is anticipated.
HUD	A monitoring review of TDHCA and TDRA's disaster recovery program, including fundability documentation, subrecipient management and policy controls for fraud, waste and mismanagement.	Reporting	HUD conducted this monitoring visit the week of January 10-14th, 2011.
HUD	A monitoring review of TDHCA and TDRA's disaster recovery program, including fundability documentation, subrecipient management and policy controls for fraud, waste and mismanagement.	Reporting	HUD conducted this monitoring visit the week of April 4 - 8th, 2011.
DHS	The Dept. of Homeland Security conducted an audit of FEMA's management of the Alternative Housing Pilot Project at the Department.	Reporting	DHS conducted the TDHCA portion of this audit the week of March 28 – April 1st , 2011.
HUD	A review of the Homeless Prevention and Rapid Re-housing Program.	Planning	HUD anticipates fieldwork in July 2011.

**INTERNAL AUDIT DIVISION
BOARD REPORT ITEM
MAY 5, 2011**

Presentation and discussion of recent external audit reports.

Recommend Action

No action required, information only.

Background

The following reports from external audits or monitoring visits were recently released:

- **2010 Statewide Single Audit**

There were three findings identified; none of these findings had questioned costs.

- Significant Deficiency - In the ACS contractor's automated systems (Worldtrac and Portfolio) three issues were identified related to access controls. This was a prior finding from 2009.
- Significant Deficiency and Scope Limitation - Quarterly reports to HUD's Disaster Recovery and Grant Reporting System (DRGR) were not able to be verified because the amounts reported could not be traced to the accounting system.
- Non-Compliance – The quarterly ARRA reports for December 2009 and March 2010 were both submitted past the 10-day requirement.

- **HHS LIHEAP Monitoring Report**

There were three issues identified:

- The state's co-payment component and its associated requirements may not fully comply with the LIHEAP statutes.
- The state's allocation formula used to distribute funds to its subrecipients is not included in its FY2010 LIHEAP Detailed Plan.
- There is no state-wide computer database for subrecipients to use for entering LIHEAP applications and client data.

- **HUD HOME Davis-Bacon Monitoring Report**

HUD concluded that the Department's administration, enforcement and federal labor standards were adequate. There were two findings:

- Federal Labor Standards Administration – The monitors identified problems with the Department's monitoring procedures, documentation and follow-up. The monitoring tool and testing spreadsheet needs improvement to address significant labor standards issues.

- The Department has delegated the authority to perform federal labor standards monitoring of construction work subject to the Davis Bacon and Related Acts to for-profit developers and construction contractors. This may be a conflict of interest.

Both of these findings were cleared by HUD's Office of Labor Relations in January.

- DOE WAP Monitoring for February 2011

DOE identified two concerns during this monitoring visit:

- The risk assessment tool should emphasize and improve the quality of the weatherization effort in units statewide.
- DOE expressed concern about the achievement of production and expenditure goals for the regular DOE grant.
- All monitoring issues identified in previous reports were cleared.

- HUD-OIG Disaster Recovery Program

HUD-OIG found that the Department's monitoring activities provided assurance that the ACS contractor generally complied with Federal and State regulations. They identified a minor instance of non-compliance. A reimbursement of \$71,691 for a mark-up for "Admin Fees on Subcontractors" was calculated using a cost plus percentage of cost method that is not allowed under CDBG rules.

- NeighborWorks Quality Control and Compliance Review of the National Foreclosure Mitigation Counseling (NFMC) Program

There was one finding and two concerns noted:

- Finding - The Department's records retention policy did not include required wording regarding records retention for the NFMC program.
- Concern - A-133 audit findings should be resolved so that they don't impact the NFMC program.
- Concern - Policies and procedures are needed to track the source and expenditure of match funds.
- The finding was closed based on the response submitted by the Department.

- NSP Needs Assessment Report

HUD contracted with Training and Development Associates, Inc. to assess the Neighborhood Stabilization Program (NSP) to identify training needs and to recommend technical assistance. They identified the following findings:

- Many of the obligations are at risk due to pipeline issues.
- There is a bottleneck in the program design that has impeded progress. Each unit potentially requires multiple closings and there are insufficient staff to process these closings.
- Subrecipients were allowed to expand their programs with no increases in their capacity.
- The Department required subrecipients to be 70% expended by the end of February, and most will not achieve that goal. As of January 25th, 6 of 37 subrecipients were at 50% or less.

FEDERAL PORTION OF THE STATEWIDE SINGLE AUDIT
REPORT FOR THE FISCAL YEAR ENDED AUGUST 31, 2010

TEXAS



TEXAS STATE AUDITOR'S OFFICE
JOHN KEEL, CPA

Texas Department of Housing and Community Affairs

Reference No. 11-25

Allowable Costs/Cost Principles

Cash Management

Earmarking

Reporting

Special Tests and Provisions - Environmental Reviews

Special Tests and Provisions - Environmental Oversight

(Prior Audit Issue - 10-30)

CDBG - State-Administered Small Cities Program Cluster

Award year - N/A since disaster-based only

Award number - B-06-DG-48-0002

Type of finding - Significant Deficiency

Access to migrate code changes into production as well as system administrator privileges should be restricted appropriately based on job function to help ensure adequate internal controls are in place and segregation of duties exist. Access to deploy and develop code changes should be segregated. Similarly, system administrative access should also be restricted to non-developers. Texas Department of Housing and Community Affairs (TDHCA) outsource both WorlTrac and Portfolio maintenance and operations to multiple third-party providers. Portfolio's primary function is applicant eligibility while WorlTrac is the primary source of the financial transactions. During the performance of general controls and application level test work for the WorlTrac and Portfolio applications, the following items were noted:

Questioned Cost:	\$0
U.S Department of Housing and Urban Development	

- Through February 1, 2010, three developers had access to the administrative server-level IDs for the Portfolio application server, while one developer also had direct administrative access on the application server. These three developers also had Database Administrator (DBA) rights on the production database server. Overall, the three developers could also deploy code changes into production. In addition, there was no policy restricting the use of generic IDs during the same period. Generic IDs were in use by the above developers that allows them access to administrative functions on the servers.
- Access to the disbursement file was open to all Affiliated Computer Services (ACS) Domain users as it is placed on a shared drive. Access should be restricted only to the disbursements team and the ACS Finance team. This access was appropriately restricted as of December 2009.
- One application developer has access to migrate WorlTrac code changes into production and was intentionally assigned this access as part of his daily job function; however, no additional monitoring control was put in place to mitigate the associated risk. This same developer was noted to have administrative access on the WorlTrac application and the database production servers. Additionally, there are no password restrictions in place at the operating system level and no policy restricting the use of generic IDs.

Recommendation:

Management should implement robust information technology general controls over all key applications and underlying systems. Information technology general controls should be in place to restrict high-privileged access to applications, servers and databases, enforce generic ID policies and monitor access rights on the application, and servers and databases. Developer access to administrative functions on any production system results in the risk of unauthorized changes to applications and data. Additionally, developer access to move their code changes into production increases the risk that unauthorized changes to application functionality have been deployed into the production environment. Developer access to production should also be segregated. Further, management should remove system administrative privileges granted to the developers.

HOUSING AND COMMUNITY AFFAIRS, TEXAS DEPARTMENT OF

Management Response and Corrective Action Plan:

The Texas Department of Community Affairs (TDHCA) agrees with the finding and is committed to effecting remaining corrective actions. As noted above in the current finding and in TDHCA's responses on pages 220 and 221 of SAO Report 10-339, "Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2009," many corrective actions were implemented by mid-FY 2010. TDHCA will continue to work with the vendor, ACS, to implement needed IT controls by February 14, 2011, as described below.

Detailed Responses for Each Audit Issue:

The first two bullet points in this finding were previously noted in SAO Report 10-339. All corrective actions were completed in December 2009 and February 2010, as stated in the SAO Report 10-339 response.

Regarding the first two sentences in the third bullet, in our response in SAO Report 10-339, we stated: "Administrator access and access to migrate code change were removed from developers on January 30, 2010." In January 2010, administrator access and access to migrate code were removed within the WorlTrac application and its supporting database, but through an oversight we did not remove a developer's access at the WorlTrac operating system level until we became aware of this issue in December 2010, during the course of audit fieldwork. As of December 2010, all administrative and production access has been removed from the developer.

Regarding the last sentence of the third bullet, we implemented password restrictions at the application level during the previous audit period, and these same restrictions will be added to the operating system level no later than February 14, 2011. The procedure for Portfolio system generic IDs described in our response in SAO Report 10-339 has also been followed for the WorlTrac system since January 2010. We will formalize this procedure by documenting it in the Texas HAP WorlTrac IT Security Policy no later than February 14, 2011.

Implementation Date: February 14, 2011

Responsible Person: Curtis Howe

Reference No. 11-26

Reporting

Earmarking

(Prior Audit Issue - 10-28)

CDBG - State-Administered Small Cities Program Cluster

Award year - N/A since disaster-based only

Award numbers - B-06-DG-48-0002 and B-08-DI-48-0001

Type of finding - Significant Deficiency and Scope limitation

The requirements for submission of a Performance Evaluation Report (PER) pursuant to 42.U.S.C. 12708 and 24 CFR 91.520 are waived for Community Development Block Grant (CDBG) Disaster Recovery Grantees Under 2008 CDBG Appropriations. However, the alternative requirement is that each grantee must submit a quarterly performance report, as U.S. Department of Housing and Urban Development (HUD) prescribes, no later than 30 days following each calendar quarter, beginning after the first full calendar quarter after grant award and continuing until all funds have been expended and all expenditures reported. Each quarterly report will include information about the uses of funds during the applicable quarter including (but not limited to) the project name, activity, location, and national objective; funds budgeted, obligated, drawn down, and expended; the funding source and total amount of any non-CDBG disaster funds; beginning and ending dates of activities; and performance measures such as numbers of low- and moderate-income persons or households benefiting. The quarterly report to HUD must be submitted using HUD's Internet-based Disaster Recovery Grant Reporting (DRGR) System and, within 3 days of submission, be posted on the grantee's official Internet site open to the public (February 13, 2009 Federal Register Vol. 74, No. 29, page 7252).

Questioned Cost:	\$0
U.S. Department of Housing and Urban Development	

HOUSING AND COMMUNITY AFFAIRS, TEXAS DEPARTMENT OF

The Department of Housing and Community Affairs (TDHCA) is responsible for submitting the quarterly performance reports for the 2nd Supplemental Rita funding, as well as the Ike/Dolly disaster funds received. The accuracy and completeness of these reports could not be verified as the amounts reported could not be traced to accounting records. The database which supports the reporting is continuously updated for new transactions and adjustments. TDHCA has the capability to query the database as of a specific date; however, during fiscal year 2010, multiple changes were made to the data with effective dates in prior quarters (i.e., the reports had already been filed).

Some of the changes included: (1) HUD contacted TDCHA during fiscal year 2010 and asked that the expenditures be presented in further detail, by project, instead of at a summary level; therefore TDCHA has been modifying and reconciling the database to present the expenditures by project, (2) system changes were also implemented into the DRGR system during the audit year, and (3) action plan modifications and expenditure adjustments were made subsequent to initial filings of some of the quarterly performance reports that resulted in the reports being rejected and requested to be resubmitted by HUD.

Also the DRGR reports are to be submitted within 30 days following quarter end. However, the date submitted on the DRGR system is the last date submitted, including revisions. The e-mail notifications retained by TDHCA were unclear as to which version of the reports they supported. Therefore timeliness was not able to be confirmed.

Additionally, it was noted that the Rita and Ike/Dolly performance reports for quarters ending December 31, 2009, March 31, 2010, and June 30, 2010 were posted to the TDHCA website. However, the timing of when these reports were posted could not be verified to confirm the 3-day posting requirement after submission. The September 30, 2010 performance reports were not on the agency's website as of January 2011.

Recommendation:

TDHCA should continue to work with HUD to ensure the all fiscal year quarterly reports are revised and resubmitted. TDHCA should also ensure that clear documentation is maintained to verify the timing of report submissions and posting of the reports to the THDCA website.

Management Response and Corrective Action Plan:

TDHCA will continue to work with HUD to revise and resubmit the quarterly reports as required. In addition, TDHCA will improve processes to ensure that all documentation is maintained to support the timely submission and posting of the reports.

Implementation Date: April 15, 2011

Responsible Person: Kelly Crawford

HOUSING AND COMMUNITY AFFAIRS, TEXAS DEPARTMENT OF

Reference No. 11-27

Reporting

CSBG Cluster - ARRA

Award year - October 1, 2008 to September 30, 2010

Award number - G-0901TXCOS2

Type of finding - Non-Compliance

The Texas Department of Housing and Community Affairs (THDCA) is required by OMB Circular A-133 and A-102 to submit an SF-269, Financial Status Report for regular and ARRA funding under the CSBG Cluster. The Financial Status Report (FSR) SF-269 (OMB No. 0348-0039) or SF-269A (OMB No. 0348-0038) is what recipients use to report the status of funds for all non-construction projects and for construction projects when the FSR is required in lieu of the SF-271. Each recipient must report program outlays and program income on a cash or accrual basis, as prescribed by the Federal awarding agency. The annual SF-269 report required for the regular CSBG funds is due by December 31 after the end of each fiscal year. The quarterly SF-269 report required for the ARRA CSBG funds is due by the 10th day of the month following quarter-end.

Questioned Cost:	\$0
U.S. Department of Health and Human Services	

The quarterly ARRA SF-269 reports for the quarters ending December 2009 and March 2010 both were submitted past the 10-day requirement. One was submitted 12 days late and the other was 4 days late. The remaining two quarters were submitted timely. THDCA received correspondence from HHS that the reports were due 30 days after quarter end similar to the non-ARRA SF-269. However subsequent to that correspondence, the program rules were revised and the ARRA SF-269 deadline was redefined as 10 days after quarter end.

Recommendation:

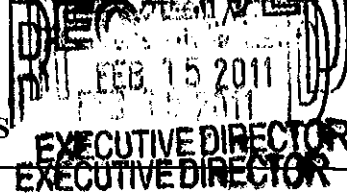
THDCA should continue to file the ARRA SF-269 reports within the 10-day time frame.

Management Response and Corrective Action Plan:

TDHCA acknowledges the recommendation related to the quarterly ARRA SF-269 reports and will continue to file the ARRA SF-269 reports within the 10 day time frame.

Implementation Date: April 2010

Responsible Persons: David Cervantes and Esther Ku



ADMINISTRATION FOR CHILDREN AND FAMILIES
Office of the Assistant Secretary, Suite 600
370 L'Enfant Promenade, S.W.
Washington, D.C. 20447

Mr. Michael Gerber
Executive Director
Texas Department of Housing and Community Development
221 East 11th Street
Austin, Texas 78701-2410

FEB 11 2011

Dear Mr. Gerber:

From July 27 to 29, 2010, Federal staff from the U.S. Department of Health and Human Services (HHS) conducted a compliance review of Texas' fiscal year (FY) 2010 Low Income Home Energy Assistance Program (LIHEAP). We appreciate the cooperation and courtesies that your staff provided during the review.

The State agency staff provided an overview of the operations of the LIHEAP program. Our review covered the application intake, income verification, and payment processes for each of the LIHEAP components. We also reviewed the State's financial system, monitoring reports, and fair hearing process.

During the exit conference, we identified several areas of concern. We have listed below the outstanding issues, information still needed, and actions the State may take to resolve the issues.

Required Actions

Issue 1

During our visit, we learned that the State has required corrective actions of the following community action agencies within the State's LIHEAP network due to financial mismanagement involving LIHEAP funds:

- El Paso Community Action Program (CAP)/Project BRAVO Inc.;
- Community Action Program Inc. (Abilene);
- Tri-County Community Action, Inc. (Northeast Texas); and
- Community Action Social Services and Education, Inc. (Houston).

Resolution

We applaud the State's efforts to anticipate and act quickly to ensure that energy assistance services remain uninterrupted and that low income households are minimally impacted. Please provide our office with detailed summaries of the State's corrective action plans for each of these four agencies, as well as their progress toward meeting the State's requirements.

Recommendations

Issue 1

The State operates a Co-Payment Component under its Comprehensive Energy Assistance Program (CEAP) in addition to its Crisis, Elderly and Disabled, and Heating and Cooling Components. All Co-Payment Component recipients must sign a Client Service Agreement, which among other requirements, stipulates that they must pay a portion of their utility bills, attend mandatory conservation education sessions, and either be employed or in school. Failure to meet the provisions of the Client Service Agreement results in early termination from CEAP altogether, meaning such clients are ineligible for any other CEAP components, including Crisis, until the following program year.

We recognize and appreciate the State's efforts to reduce dependency on its LIHEAP program. However, we are concerned about the implications of creating a condition of eligibility for LIHEAP through the five percent allowable under section 2505(b)(5) LIHEAP statute (42 U.S.C. § 8624(b)(5)) for "Assurance 16" activities which allow for energy conservation education, budgeting, etc. We believe Assurance 16 activities should be kept separate from the provision of monetary LIHEAP benefits. In addition, requiring LIHEAP clients to work or be in school raises compliance concerns, as nothing in the LIHEAP statute specifically warrants such requirements.

Furthermore, staff at the local agency we visited informed us that households without elderly, disabled, or young child members are only eligible for the Co-Payment Component. This particular policy appears to have been created at the local agency's discretion as part of its individual Priority Plan. While we appreciate the flexibility the State affords its sub-recipients, we are concerned that too much flexibility may put the State at risk of being out of compliance with the LIHEAP statute.

Section 2605(b)(5) of the LIHEAP statute (42 U.S.C. § 8624(b)(5); see also section 2602(a), 42 U.S.C. § 8621(a)) states that grantees must:

provide, in a timely manner, that the highest level of assistance will be furnished to those households which have the lowest incomes and the highest energy costs or needs in relation to income, taking into account family size, except that the State may not differentiate in implementing this section between the households described in clauses (2) (A) and (2) (B) of this subsection.

Section 2604(c) of the LIHEAP statute (42 U.S.C. § 8623(c)(1)) provides that grantees will:

- (1) not later than 48 hours after a household applies for energy crisis benefits, provide some form of assistance that will resolve the energy crisis if such household is eligible to receive such benefits;
- (2) not later than 18 hours after a household applies for crisis benefits, provide some form of assistance that will resolve the energy crisis if such household is eligible to receive such benefits and is in a life-threatening situation.

Section 2605(b)(10) of the LIHEAP statute (42 U.S.C. § 8624(b)(10)) states that grantees must:

provide that such fiscal control and fund accounting procedures will be established as may be necessary to assure the proper disbursement of and accounting for Federal funds paid to the State under this title, including procedures for monitoring the assistance provided under this title, and provide that the State will comply with the provisions of chapter 75 of title 31, United States Code (commonly known as the "Single Audit Act").

Section 2605(b)(16) of the LIHEAP statute (42 U.S.C. § 8624(b)(16)) states that grantees may:

use up to 5 percent of such funds, at its option, to provide services that encourage and enable households to reduce their home energy needs and thereby the need for energy assistance, including needs assessments, counseling, and assistance with energy vendors, and report to the Secretary concerning the impact of such activities on the number of households served, the level of direct benefits provided to those households, and the number of households that remain unserved.

Resolution

Please provide the State's justification as to how its Co-Payment Component is supported by the LIHEAP statute. Clarify whether non-vulnerable households are eligible for any other CEAP components other than the Co-Payment Component, especially crisis assistance.

Issue 2

The State distributes LIHEAP funds to its sub-recipients using an allocation formula that takes into account diverse local needs. This formula considers weather, population density, county median income, and size of elderly population. U.S. Census data are used to gather all demographic factors.

The State's allocation formula is not contained within its FY 2010 LIHEAP Detailed Plan. This is of particular importance given that the State is required to gather public input on the formation of its Plan each year. We believe that the public should have access to this information. In addition, during our visit we learned that CEAP applicants often complain that they do not understand the logic behind how their benefit is calculated. Having the allocation formula in the Plan would justify geographic differences in benefits as the formula allows for consideration of local factors. As the State also posts its LIHEAP Plan on the Texas Department of Housing and Community Affairs (TDHCA) website, the public could also access that information on the Internet if it were included as part of its Plan.

Section 2605(b)(12) of the LIHEAP statute (42 U.S.C. § 8624(b)(12)) states that grantees must:

provide for timely and meaningful public participation in the development of the plan described in subsection (c).

Section 2605(c)(1)(B) of the LIHEAP statute (42 U.S.C. § 8624(c)(1)(B)) states that grantees shall provide a LIHEAP plan to HHS that:

describes the benefit levels to be used by the State for each type of assistance including assistance to be provided for emergency crisis intervention and for weatherization and other energy-related home repair.

Section 2605(c)(2) of the LIHEAP statute (42 U.S.C. § 8624(c)(2)) states that grantees shall ensure that:

each plan prepared under paragraph (1) and each substantial revision thereof shall be made available for public inspection within the State involved in such a manner as will facilitate timely and meaningful review of, and comment upon, such plan or substantial revision.

Resolution

We strongly encourage you to amend your FY 2010 LIHEAP Detailed Plan to include details about your allocation formula and attach the formula as supporting documentation. We also suggest that you include these same details in your future Detailed Plans, as well as to your Abbreviated Plans if there are changes to the formula for that year.

Issue 3

We learned that the State does not have a State-wide computer database that it requires all sub-recipients to use for entering LIHEAP applications and client data. Most States

we have recently visited have such a system. While you clarified that you do have a State-wide computer system through which sub-recipients are required to submit financial reports to your office, we believe that not being able to access sub-recipient LIHEAP applications and client data puts the State at increased risk for waste, fraud, and abuse. Furthermore, this limitation prevents the State from tracking and reporting key information about clients it serves in an efficient manner because you are unable to produce reports upon demand regarding household characteristics, types of assistance provided, etc. Frequency of data entry error is also increased when benefits are hand-calculated using the State's allocation formula, as opposed to a State-wide computer system calculating the benefits automatically.

Presidential Executive Order 13520, *Reducing Improper Payments and Eliminating Waste in Federal Programs*, issued on November 23, 2009, has placed a renewed emphasis on transparency and accountability in Federal programs.

The LIHEAP block grant regulations at 45 C.F.R. § 96.84(c) discusses the prevention of waste, fraud and abuse, and provide that:

Grantees must establish appropriate systems and procedures to prevent, detect and correct waste, fraud and abuse in activities funded under the low-income home energy assistance program. The systems and procedures are to address possible waste, fraud and abuse by clients, vendors, and administering agencies.

Additionally, the LIHEAP Performance Measures Work Group(s) have developed new LIHEAP performance measures that HHS agrees are useful to track and report. States without electronic access to subgrantee data will face more challenges trying to implement the new performance measures.

Resolution

The State expressed a desire to move toward the kind of computer system described above, but shared with us that it had concerns about cost and wanted to obtain more information from other States about best practices. We recommend that you reach out to various State LIHEAP directors to discuss with them how they have successfully met both cost and design challenges.

We also recommend that the State contact Ralph Markus at TEL: (410) 767-7415 or rmarkus@dhr.state.md.us to learn more about the information the LIHEAP Performance Measures Implementation Work Group is gathering about upcoming T&TA opportunities and examples of best practices for such systems.

Additionally, the State may wish to consider submitting an application for a Leveraging Incentive funds and/or REACH funds in order to pilot test improvements in data collection and reporting.

Summary

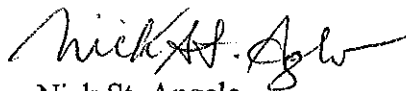
Please provide the information requested above within 60 days from the date of this letter so that we may finalize the review of Texas's FY 2010 LIHEAP program. Where problems have been identified, HHS staff will be available to assist the State in developing solutions. A final report will be issued to the State, closing out the review, after all issues are resolved.

Under HHS block grant policy, grantees have primary responsibility for interpreting the LIHEAP statutory provisions. The HHS block grant regulations at 45 C.F.R. Part 96, Subpart E provide that the Department will defer to a grantee's interpretation of the statute unless that interpretation is "clearly erroneous." We may ask for an opinion from your legal representative, if necessary. If, after considering the State's responses, the Department still judges any of the State's practices to be out of compliance, an opportunity for a hearing will be offered before any sanction is imposed. As required by regulation 45 C.F.R. Part 96, Subpart E, we will notify the State if necessary and, as appropriate, the State's auditors, of our preliminary decision that the State's interpretation of the statute is clearly erroneous.

If the Department determines that the State has misspent Federal funds and/or is not expending funds substantially in compliance with the statute, the Department will order the repayment of amounts misspent or will withhold funds until the State complies with the statute.

If you or your staff has any questions, please contact Karmen Blackwell of my staff at karmen.blackwell@acf.hhs.gov or (202) 401-4864.

Sincerely,



Nick St. Angelo
Director
Division of Energy Assistance
Office of Community Services

cc: Mr. Michael DeYoung, Director, Community Affairs Division
Ms. Sharon Gamble, Manager, Energy Assistance Section
Ms. Cathy Collingsworth, Project Manager, Fiscal and Planning, Energy Assistance



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

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April 4, 2011

Mr. Nick St. Angelo
Director, Division of Energy Assistance
370 L'Enfant Promenade S.W.
Washington, D.C. 20447

Dear Mr. St. Angelo:

The Department is in receipt of your correspondence dated February 11, 2011 regarding the compliance review visit conducted by staff from the U.S. Department of Health and Human Services (HHS) from July 27 to 29, 2010. Our response is detailed below.

Required Actions

Issue 1 requested *“detailed summaries of the State’s corrective action plans for each of these four agencies, as well as their progress toward meeting the State’s requirements.”*

Attachment A of this document provides the requested summary.

Recommendations

Issue 1 – *“Please provide the State’s Justification as to how the Co-Payment component is supported by the LIHEAP statute. Clarify whether non-vulnerable households are eligible for any other CEAP Components other than the Co-Payment Component, especially crisis assistance.”*

Staff has reviewed the LIHEAP statute and cannot identify a prohibition against the type of assistance as described in the Co-Payment component. As discussed with LIHEAP staff during the monitoring visit, the copayment amount is usually a nominal amount which is intended to aid in the transition of the household into energy self sufficiency. TDHCA has utilized the Co-

Payment component for 16 years and has experienced some success with the transition to Energy self Sufficiency. Non-vulnerable households are eligible for other CEAP components as well, including crisis assistance.

TDHCA has established a working group to evaluate the current program design of the state utility assistance under LIHEAP and is projecting to revise the design to simplify the program. TDHCA intends to submit a 2012 plan which reflects the new LIHEAP program design reflecting the efforts of the workgroup, public input, and federal requirements including the Program integrity workgroup recommendations.

Issue 2 requested the state *“amend your FY 2010 LIHEAP Plan Detailed Plan to include details about your allocation formula and attach the formula as supporting documentation. We also suggest that you include these same details in your future detailed plans, as well as to your Abbreviated Plan if there are changes to the formula for that year.”*

TDHCA proposes to amend the 2010 LIHEAP Plan and attach the formula as support documentation. As requested, the Texas State LIHEAP plans (detailed and abbreviated) will include the formula. TDHCA intends to update the formula as soon as the new census data is released.

Attachment B of this document contains the current formula.

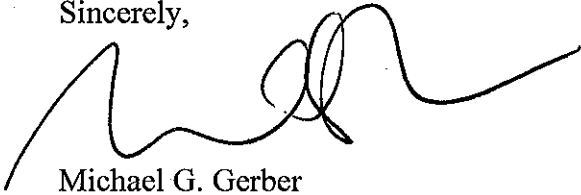
Issue 3 – recommended that we evaluate “and reach out to various state LIHEAP directors to discuss with them how they have successfully met both cost and design challenges” for data collection and reporting.

On February 28, 2011 TDHCA staff traveled to Washington DC for the National Energy Assistance Directors Association (NEADA) winter meeting where staff talked to various states about their current systems and the ability to evaluate their system design. Staff also inquired about open source systems that have already been designed by other states with federal funds which could be evaluated by TDHCA technical staff in order to ascertain their appropriateness for utilization by the state of Texas LIHEAP program.

TDHCA is actively involved in the LIHEAP Program Integrity Work Group in order to identify and accommodate recommendations into the evaluation of existing systems (from other states), and/or the procurement of a system which can provide functionality and assist in the verification of income, validation against a list of incarcerated individuals, lists of deceased individuals, and other potential requirements that emanate from the work group.

TDHCA appreciates the efforts of the HHS staff to assist in the evaluation of the State of Texas programs that deliver utility assistance and weatherization services to low income Texans and would like to thank the LIHEAP staff for the visit and subsequent technical assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael G. Gerber". The signature is fluid and cursive, with a large loop in the middle.

Michael G. Gerber
Executive Director

clc

Attachment A

El Paso Community Action Program, Project BRAVO

The Department sent a letter on December 22, 2009 to El Paso Community Action Program, Project BRAVO announcing the visit of Meloria Partners. That visit resulted in the Meloria report in January 2010 with 33 findings. Project BRAVO submitted to the Department a Quality Improvement Plan in April 2010 to address these findings. The department's response to this QIP was issued on April 15, 2010 detailing 13 findings still unresolved.

Initial notice from Dept: December 22, 2009

Meloria report: January 2010 with 33 findings

QIP: April 2010

The Board of Directors for El Paso Project Bravo has approved the changes that were recommended in the Meliora Assessment. The remaining issues will be resolved upon the submission of the documentation from the El Paso Project Bravo staff. The Department anticipates receiving the documentation the last week of March 2011.

Tri-County Community Action Agency

The Department sent a letter on January 22, 2010 to Tri-County Community Action Agency announcing the visit of Meloria Partners. That visit resulted in the Meloria report in February 2010 with 21 findings. Tri-County Community Action Agency submitted to the Department a Quality Improvement Plan in May 2010 to address these findings. The Department's response to this QIP and additional information provided to the Department was issued on February 14, 2011 detailing 3 unresolved findings.

Initial notice from Dept: January 22, 2010

Dept response June 14, 2010 with 10 unresolved findings

Dept response October 15, 2010 with 7 unresolved findings

Dept response February 14, 2011 with 3 unresolved findings

Community Services Agency South TX

The Department sent a letter to Community Services Agency South TX announcing the visit of Meloria Partners on April 26, 2010. That visit resulted in the Meloria report in May 2010 with 27 findings. Project BRAVO submitted to their first QIP on July 30, 2010 to address these findings. The department's response to this QIP was issued on November 15, 2010 detailing 26 unresolved finding and 1 finding pending resolution.

Initial notice from Dept: April 26, 2010

Meloria Report issued: May 2010, 27 findings

QIP: July 30, 2010

Dept response November 15, 2010 with 26 unresolved findings
QIP: December 15, 2010
Dept response in progress

Community Action Program, Inc.

The Department sent a letter to Community Action Program, Inc. announcing the visit of Meloria Partners on April 13, 2010. That visit resulted in the Meloria report in May 2010 with 34 findings. Community Action Program, Inc. notified the Department on September 23, 2010 of the intent to dissolve the Agency as of October 1, 2010.

Copies of all Meloria reports were provided to Mr. Zack Poimboeuf at the time of the monitoring.

Attachment B

Distribution of LIHEAP funding for CEAP and WAP

Texas Administrative Code

TITLE 10 COMMUNITY DEVELOPMENT
PART 1 TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
CHAPTER 5 COMMUNITY AFFAIRS PROGRAMS
SUBCHAPTER D COMPREHENSIVE ENERGY ASSISTANCE PROGRAM
RULE §5.403 Distribution of CEAP Funds

RULE §5.403 Distribution of CEAP Funds

(a) The Department distributes funds to Subrecipients by an allocation formula.

(b) The formula allocates funds based on the number of low-income households in a service area and takes into account the special needs of individual service areas. The need for energy assistance in an area is addressed through a weather factor (based on heating and cooling degree days). The extra expense in delivering services in sparsely populated areas is addressed by an inverse population density factor. The lack of additional services available in very poor counties is addressed by a county median income factor. Finally, the elderly are given priority by giving greater weight to this population. The five factors used in the formula are calculated as follows:

(1) County Non-elderly Poverty Household Factor (weight of 40%) is defined by the Department as the number of Non-elderly Poverty Households in the County divided by the number of Non-elderly Poverty Households in the State;

(2) County Elderly Poverty Household Factor (weight of 40%) is defined by the Department as the number of Elderly Poverty Households in the County divided by the number of Elderly Poverty Households in the State; and

(3) County Inverse Poverty Household Density Factor (weight of 5%) is defined by the Department as:

(A) The number of Square Miles of the County divided by the number of Poverty Households of the County (equals the Inverse Poverty Household Density of the County); and

(B) Inverse Poverty Household Density of the County divided by the Sum of Inverse Household Densities.

(4) County Median Income Variance Factor (weight of 5%) is defined by the Department as:

(A) State Median Income minus the County Median Income (equals County Variance); and

(B) County Variance divided by sum of the State County Variances.

(5) County Weather Factor (weight of 10%) is defined by the Department as:

(A) County Heating Degree Days plus the County Cooling Degree Days, multiplied by the Poverty Households, divided by the sum of County Heating & Cooling Degree Days of Counties (equals County Weather); and

(B) County Weather divided by the total sum of the State County Weather.

(C) All demographic factors are based on the decennial U.S. Census.

(D) Total sum of subsection (b)(1) - (5) of this section multiplied by total funds allocation equals the County's allocation of funds. The sum of the county allocations within each Subrecipient service area equals the Subrecipient's total allocation of funds.



cc: TG, TK, LM, JA

**U. S. Department of Housing and Urban
Development**
Fort Worth Regional Office, Region VI
Office of Labor Relations
801 Cherry Street, Unit #45, Suite 2500
Fort Worth, Texas 76102
Ph - 817-978-5617 Fax - 817-978-5565
www.hud.gov www.espanol.hud.gov

August 13, 2010

Mr. Michael Gerber, Executive Director
Texas Department of Housing and Community Affairs
P.O. Box 13941
Austin TX, 78711-3941

Dear Mr. Gerber:

On June 8-10, 2010, Ms. Melanie Dalton, Mr. Glen Chafey, Mr. Steven Bales, Ms. Dondra Merrell and Ms. Joyce F. Ingram conducted an on-site review of your agency's Federal labor standards administration and enforcement under applicable federal prevailing wage requirements and Section 286 of the National Affordable Housing Act of 1990 (NAHA).

The enclosed monitoring report provides our evaluation of your agency's performance in the areas listed in the report. A review of the State of Texas – Texas Department of Housing and Community Affairs (TDHCA), HOME program resulted in two findings. Corrective action and response are due to our office by **September 29, 2010**. Notwithstanding the deficiencies cited in this report, we conclude that TDHCA's administration and enforcement and Federal labor standards are adequate. If you require additional time to respond to the findings, please notify our office before the due date.

We appreciate the courtesies and cooperation extended by you and your staff. Ms. Joyce F. Ingram, Labor Relations Specialist, will be available for technical assistance to resolve the findings noted in the report. If you require assistance, or further information concerning the matters discussed in this report, please not hesitate to have your staff contact Ms. Ingram at 817.978.5622 or you may contact me directly at 817.978.5619.

Sincerely,

A handwritten signature in black ink, appearing to read "Jerlinda D. Banks".

Jerlinda D. Banks
Regional Labor Relations Officer

Enclosure

cc: T. Gouris, TDHCA
P. Murphy, TDHCA

**Federal Labor Standards Monitoring Review
Texas Department of Housing and Community Affairs
Review Conducted June 8-10, 2010**

**FEDERAL LABOR STANDARDS MONITORING REVIEW
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
HOME PROGRAM**

SUMMARY

The review was performed June 8-10, 2010, to evaluate the administration and enforcement of Federal labor standards requirements by the State of Texas, Texas Department of Housing and Community Affairs (TDHCA). The scope of the review was comprehensive and broad in nature to determine how the TDHCA administered and enforced Federal labor standards requirements. The Office of Labor Relations staff who conducted the review was Ms. Joyce F. Ingram (Team Lead), Fort Worth Regional Office of Labor Relations, Mr. Glen Chafey, Oklahoma City HUD Office and Mr. Steve Bales, Ms. Melanie Dalton, and Ms. Dondra Merrell from the Regional Office of Labor Relations HUD Atlanta (Region IV).

The review focused on examining critical elements of Federal labor standards administration and enforcement including: staffing, information systems, monitoring procedures, technical assistance and training, reporting requirements, and enforcement files.

TDHCA files reviewed are listed below:

STATE OF TEXAS – TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS-HOME FUNDS			
Project Name	Grantee	Project Number	Grant/Contract Amount
Floresville Senior Housing	CHEOC	1000969	\$1,682,300
Cambridge Crossing	Corsican OMA Housing	1000991	\$5,010,115
Huntington Charger	Hunting Charger, LP	1000998	\$2,941,782
Encino Pointe	CAHFC/Encino Pointe, LLC	1000113	\$3,000,000
Brookhollow Manor Apts.	FDI-Brookhollow Manor, Ltd	1001000	\$2,145,586
Buena Vida	LaFeria/Buena Vida	1000962	\$1,118,980
CreekView Apts.	Highland Lake Hsgn. Corp.	1000968	\$3,250,000
Northview Apts.	FDI-Northview, Ltd.	1001001	\$2,760,000

STATE OF TEXAS – TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS			
TAX CREDIT ASSISTANCE PROGRAM (TCAP)			
Project Name	Grantee	Project Number	Grant/Contract Amount
Candlewick Apts.	Chicory Court VI, LP	13090009720	\$3,219,157
Trinity Quality Hsng. LP	Fort Worth HA	13090009733	\$4,950,523
San Angelo River Place	San Angelo River Place, Ltd.	1309000971344	\$980,345

In addition to hard copy files being reviewed, the team also examined electronic file records of TDHCA's monitoring reviews conducted. These reviews included Brackettville Seniors Apartments, Costa Mariposa, Encino Pointe, FDI Northview, Huntington Charger, Lexington Court Phase II, The Colony Senior Community, and THF Highland Lakes projects. Records for these projects were provided by TDHCA staff on CD-ROM. There were three (3) projects submitted and reviewed that were 100 percent completed using TCAP funds that were awarded/funded after completion. The projects are: Wov Apartments, Residence @ Onion Creek, Austin, Texas, and Chicory Court VI.

Based on our review of the project files, interviews with staff, and documents provided during the review, it was found that TDHCA policies and procedures for administering and enforcing HOME funded recipients are adequate to comply with applicable Federal labor standards requirements; however, deficiencies were found within their operating policies and procedures.

This report identifies key areas of deficiencies and provides remedial actions necessary to improve TDHCA's performance. There are two (2) findings noted and one (1) concern. Corrective actions are noted in the applicable sections.

All aspects described in this report were discussed during the review and the exit conference with staff and subsequent telephone discussions. As discussed during the review, the Fort Worth Regional Office of Labor Relations will work with TDHCA to provide specific training and/or technical assistance for staff and grantees. Please provide the Office of Labor Relations with a report of corrective actions taken for the findings by September 29, 2010.

**FINDING 1 – FEDERAL LABOR STANDARD ADMINISTRATION
DAVIS BACON AND RELATED ACTS PROJECT ADMINISTRATION**

CRITERIA: The review team found significant weaknesses and deficiencies within TDHCA's monitoring procedures, documentation, and follow-up. These deficiencies affect the agency's ability to ensure compliance with prevailing wage requirements of the Davis-Bacon and Related Acts, including the requirements set forth in HUD Handbook 1344.1 REV.1 CHG 1, Federal Labor Standards Compliance in Housing and Community Development Programs, and in 29 CFR Subpart 5.5 and other relevant regulatory requirements of Title 29, as well as, Sec. 286 of the National Affordable Housing Act.

CONDITION: TDHCA's monitoring policy documents, forms, the monitoring "Testing Tool" spreadsheet, correspondences, monitoring reports were reviewed and interviews with staff was conducted. TDHCA has established a monitoring methodology. The Office of Labor Relations appreciate the State's efforts to create a system consistent in its use and application, but find TDHCA's efforts do not consistently monitor for essential and required aspects for labor standards compliance. Examples are lack of documentation in project files; contractor's eligibility not in contract documents folders, employee's interviews conducted but not completed and/or lack of employee interviews and especially employee interviews conducted by the compliance staff. The review team could not ascertain if employee interviews were compared against certified payrolls by compliance staff.

When TDHCA monitors grant sub-recipients onsite computers and a dedicated software package is used to input and organize information obtained during the review process. The software includes a monitoring review tool (a spreadsheet), which guides reviewers to obtain specific data and answer in "yes/no" fashion certain questions pertaining to labor standards. The Testing Tool spreadsheet appears mainly to constitute a transcription of data and misses crucial analysis that would be helpful and visible to auditors or HUD monitors.

CAUSE: This appearance or lack of documentation may simply be a lack of understanding/training on Federal labor standards requirements, as well as internal communication between the divisions at TDHCA.

EFFECT: While excellent in concept, the monitoring procedure and the Testing Tool spreadsheet file provided by TDHCA staff could be improved to address significant labor standards issues, i.e. contractor's eligibility, underpayment to employees, and/or overtime issues. In depth documentation, is crucial to the enforcement and administration of the Federal labor standards requirements. These documents were not found in the project files at the time of the onsite monitoring review. If corrections/improvements are not made, TDHCA may fail to properly assess and correct violations of federal prevailing wage requirements, workers due restitution may not obtain redress, and projects may be vulnerable financially.

CORRECTIVE ACTION: TDHCA must devise and implement revisions to its monitoring procedures, including information obtained through the monitoring process (Testing Tool), rules on follow-up when finding deficiencies or violations during monitoring, and the inclusion of findings or matters of concern in final written monitoring reports. After a follow up conference call conducted on Wednesday, July 28, 2010 the compliance Division has taken action to correct some areas of weakness with the Testing Tool along with monitoring procedures. TDHCA should send its corrective action to this office by September 29, 2010.

The Office of Labor Relations will continue to offer its assistance to correct this matter.

FINDING 2 - FEDERAL LABOR STANDARDS ADMINISTRATION ENFORCEMENT RESPONSIBILITIES/CONFLICT OF INTEREST

CRITERIA: In accordance with 24 CFR 92.504(a) Responsibilities: The participating jurisdiction is responsible for managing the day to day operations of its HOME program, ensuring that HOME funds are used in accordance with all program requirements and written agreements, and taking appropriate actions when performance problems arise. The use of State recipients, subrecipients, or contractors does not relieve the participating jurisdiction of this responsibility.

Additionally, under Reorganization Plan No. 14 of 1950, Federal contracting agencies have day-to-day responsibility for administration and enforcement of the Davis-Bacon labor standards provisions in covered contracts for which they are responsible or to which they provide federal assistance under laws they administer. HUD grants States primary and direct responsibility for the administration of certain labor standards procedural responsibilities.

In accordance with 24 CFR 92.356 (b), no persons who exercise or have exercised any functions or responsibilities with respect to activities assisted with HOME funds or who are in a position to participate in a decision making process or gain inside information with regard to these activities, may obtain a financial interest or benefit from a HOME-assisted activity, or have an interest in any contract, subcontract or agreement with respect thereto, or the proceeds there under, either for themselves or those with whom they have family or business ties, during their tenure or for one year thereafter. Person covered apply to any person who is an employee, agent, consultant, officer, or elected official or appointed official of the participating jurisdiction, State recipient, or subrecipient which are receiving HOME funds.

CONDITION: Construction projects funded/assisted by the HOME program are administered in several ways, of which some grant recipients are owners/for-profit private developers. These owners/developers solicit bids and contract with construction firms to perform construction work. Some developers have their own construction firm and therefore perform their own construction work. According to TDHCA staff, the developers, and sometimes the contractors, review the certified weekly payrolls and conduct confidential employee interviews to determine if they and their subcontractors are in compliance with federal labor requirements.

As a matter of policy, the TDHCA has delegated authority to perform federal labor standards monitoring of construction work subject to the Davis-Bacon and Related Acts, including the collection of confidential data through the employee interview process (use of HUD form 11) to for-profit developers and construction contractors. However, there is no authority by which the State is justified to further delegate enforcement responsibility to the very entities subject to review and possible sanction.

The review team was advised by the TDHCA staff that it is "not unusual" for a for-profit owner to designate a "Labor Standards Officer" (LSO) and for that LSO to be an employee or consultant under contract to the construction company building the project. TDHCA staff further advised, "we pass on-site enforcement responsibilities to the owner" and the "owner selects the LSO." Documentation in the project files confirms this to be case. However, there is no authority by which the State is justified to further delegate enforcement responsibility to the very entities subject to review and possible sanction. The review team also did not find justification for the possible disclosure of confidential employee information to for-profit owners and to contractors subject to those same federal prevailing wage requirements.

CAUSE: TDHCA, through the Labor Standards Officer, currently allows for a contractor/developer to oversee certain Labor Standards Enforcement requirements. This causes a certain amount of duties that are not discernibly separate for enforcement actions to be a conflict of interest.

EFFECT: When problems are found, the LSO cannot make enforcement actions. TDHCA staff did point out that “issues must be pushed up to the State” i.e. incorrect hourly wage rates noted on HUD Form 11(s) and/or overtime noncompliance. At this point, the State takes over and ensures restitution is made. The review team did not find evidence of this to be the case; however the team did find evidence of certified payroll reports (CPR) and employee interview information being passed between contractors for action.

CORRECTIVE ACTION: Compliance monitoring and enforcement actions for which the TDHCA is responsible may not be further delegated to the entities that are subject to review (contractors) or their identity-of-interest affiliates. Therefore, TDHCA must devise and implement procedures to ensure that project certified payrolls review, the performance of employee interviews, and enforcement actions are conducted by appropriate parties under existing authority. The HUD Regional Office of Labor Relations is ready to provide further assistance on this matter. TDHCA should send its corrective action to this office not later than September 29, 2010.

OTHER AREAS REVIEWED:

TRAINING - review of all training material used by the TDHCA was conducted to ensure correct and current information is conveyed to grantees regarding the appropriate administration and enforcement of Federal labor standards. Materials provided to grantees regarding Davis-Bacon and Federal labor standards requirements do not incorporate current operating guidelines published by HUD, i.e., incorrect applicability criteria for TCAP was one example.

Continuing to provide its grantees with out-dated information and forms places an increased administrative burden on staff and their grantees, could result in violations of requirements, and could result in additional costs or the disallowance of funding.

Subsequent to the onsite review the staff updated its training package for its grantees. This material appears to be generally acceptable.

We recommend the State regularly visit web-based resources, www.hudclips.org and www.hud.gov/offices/olr to assist the agency in maintaining a current and accurate inventory of HUD forms and guidebooks.

STAFFING – The area of staffing was reviewed to determine if TDHCA have a designated staff with the primary responsibility for labor compliance. It is apparent that TDHCA staff is involved with a HUD funded project from initial to final closing. The review also revealed how TDHCA staff effectively communicates when more than one person is involved to ensure that staff is informed of all proposed projects funded/assisted with HUD funds. And if there is a review process by staff determine Davis Bacon applicability prior to the issuance of grant funding. When a violation is identified due to an internal review, the designated labor person takes appropriate action to clear up any discrepancies in accordance with HUD Handbook 13441. REV-1, 3-2 (b).

However, TDHCA does not have a good plan for contingency should the primary Labor Standards Officer not be available and in the event of a personnel loss which may impact the continuity of routine operations.

The Office of Labor Relations recommends TDHCA cross train at least one other staff person (or increase staffing support) on the Federal labor standard requirements in the event the primary labor standards officer is not available for an extended period of time.

AUDIT REVIEW – The Office of Management and Budget (OMB) Circular A-133 requires that all entities that expend \$500,000 or more of federal funds must have a single audit performed by an external auditor. TDHCA as an entitlement grantee is required to comply with this requirement, as well as has the responsibility as an oversight agency to ensure that its subrecipients who meet the threshold requirement also submit a single audit and provide written guidance on corrective actions to findings associated with federal programs. TDHCA provided OLR with a list of subrecipients that are subject to OMB Circular A-133 requirements for FY2008, FY2009, and FY2010 (through March 31, 2010). OLR reviewed the list and cross-referenced the list with Federal Audit Clearinghouse for Davis Bacon related finding only. From the review, there were no audit findings related to Davis-Bacon and there are no concerns related to this aspect of the monitoring review.

TECHNICAL ASSISTANCE – ADDITIONAL CLASSIFICATION REQUESTS

Currently, TDHCA submits all additional classification requests to the HUD Regional Office of Labor Relations for processing. The Regional Office of Labor Relations then forwards those requests to the Department of Labor for determination. In accordance with HUD Handbook 1344.1, Rev-1 Chg-1, the State may submit requests for additional classifications directly to the Department of Labor instead of processing these requests through the HUD Regional Office of Labor Relations. TDHCA must begin processing additional classification requests effective on the date of this letter. This direction was previously given via email on July 7, 2010, to TDHCA staff by Jerlinda D. Banks, Regional Labor Relations Officer.

An exit conference was conducted on June 10, 2010 with the Review Team and staff from TDHCA which included Tim Irvine, Tom Gourdis, Lora Myrick, Carmen Roldan, Lucy Trevino and Ernest Green. All aspects of the review with the exception of the Single Audit Review were discussed. TDHCA should contact the Regional Office of Labor Relations to schedule a follow up technical assistance session, where the critical testing tool error and necessary corrections/enhancements will be discussed. The Office of Labor Relations anticipates conducting the technical assistance session in Fort Worth by September 30, 2010.

TDHCA is doing an adequate job of administration and enforcement of the Davis-Bacon requirements.

< END >



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

www.tdhca.state.tx.us

Rick Perry
GOVERNOR

Michael Gerber
EXECUTIVE DIRECTOR

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December 15, 2010

Ms. Jerlinda D. Banks, Regional Labor Relations Officer
U.S. Department of Housing and Urban Development
Ft. Worth Regional Office -- Region VI
Office of Labor Relations
801 Cherry Street, Unit #45, Suite 2500
Ft. Worth, Texas 76102

Dear Ms. Banks:

The Texas Department of Housing and Community Affairs (the "Department") is providing a response to Finding 2 identified in the monitoring report issued by your office August 13, 2010, reporting the results of the on-site monitoring review conducted June 8-10, 2010, pertaining to federal labor standards administration and enforcement.

The Department appreciates the additional time to resolve this finding, as well as your time and guidance during a technical assistance visit with your office on November 23, 2010 to discuss and work together toward a resolution for this finding. During our visit, Department staff agreed to incorporate additional steps in an effort to clearly define the role and functions of the Labor Standards Officer (LSO) at the grantee level and reinforce the importance of the LSO's independence from the construction arm of an entity when the grantee has the LSO responsibilities and will be constructing the project.

To strengthen the process and ensure that there is separation and independence, the Department will implement the following:

- Educate the for-profit entities that will be performing the LSO responsibilities and who have a construction arm that will be constructing the project, the importance of the separation and independence of the LSO responsibilities by updating Department training materials and presentations. The pre-construction conference attendees will be provided the updated materials and guidance as well as have the new process, forms and responsibilities explained in great detail. The Department will also require the LSO to be a member of the grantee's administrative office staff and not a staff member from the construction arm.
- The Department will provide all LSOs with the Department's Fraud, Waste and Abuse hotline number as well as the Department of Labor's hotline number to utilize should they ever witness, be told or be privy to a violation of federal labor laws. They are encouraged to report such practices and that they may do so anonymously.
- The Department will add criteria to the monitoring scope and identify these contracts as high risk. All grantees that will be performing the LSO responsibilities and constructing the project will be monitored more frequently by Department staff to ensure the separation and independence of

these duties and responsibilities are not compromised and carried out as prescribed by the Department.

- The Department will provide an Authorization and Consent for Release of Information form to be utilized by the LSO for conducting employee interviews. Prior to conducting an employee interview, the LSO will obtain written consent from the employee authorizing them to inquire and collect certain confidential data required by the Form HUD-11 Record of Employee Interview. The release will in no way waive or reduce any protections or rights of the employees under federal labor laws or any other laws.

The Department appreciates the opportunity to address the identified issue and hope we have provided your office with the necessary information to clarify and resolve the remaining issue. We also are very appreciative of the technical assistance and cooperation we have received from your office. We look forward to hearing from you and welcome more opportunities to work together in the future for the continuous improvement and strengthening of our administration and enforcement of federal labor laws and requirements.

If you have any questions, please do not hesitate to contact me or Lora Myrick, Director of Program Services, directly at (512) 475-3033 or via e-mail at lora.myrick@tdhca.state.tx.us any time.

Sincerely,



Michael G. Gerber
Executive Director

MGG:lm

CC: Tim Irvine, General Counsel - TDHCA
Tom Gouris, Executive Deputy Director, TDHCA
Lora Myrick, Director of Program Services - TDHCA
Jeannie Arellano, Director of HOME Program - TDHCA
Patricia Murphy, Chief of Compliance - TDHCA



RECEIVED
JAN 28 2011
EXECUTIVE DIRECTOR

SCANNED
CC: MG, TG, LM,
JA, CD

**U.S. Department of Housing and Urban
Development**

Fort Worth Regional Office, Region VI
Office of Labor Relations
801 Cherry Street, Unit #45, Suite 2500
Fort Worth, Texas 76102

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January 20, 2011

Mr. Michael Gerber, Executive Director
State of Texas
Texas Department of Housing and Community Affairs
222 East 11th - PO Box 13941
Austin, TX 78711-3941

Dear Mr. Gerber:

REFERENCE: (1) Letter from HUD (Banks) to Agency (Gerber), dated August 13, 2010, Labor Standards Compliance Review Report

(2) Letter from Agency to HUD, dated December 15, 2010, Labor Standards Compliance Review Response

SUBJECT: State of Texas – Texas Department of Housing and Community Affairs (TDHCA)
HOME Program

Dear Mr. Gerber:

This letter is in response to your letter dated December 15, 2010, (Ref.2) regarding the corrective action(s) taken by your agency to resolve the finding and concern from our review. Our office has reviewed the corrective action(s) taken to provide HUD with the assurance that adequate administration and enforcement of federal labor standards is in place.

The steps are commendable, and appear to provide a good framework for ensuring adequate administration and enforcement. A subsequent follow-up discussion with Lora Myrick, Director of Program Services, on January 20, 2011, indicated implementation of these corrective actions is effective immediately.

The Office of Labor Relations is clearing the findings and considers this review closed. The State of Texas, Texas Department of Housing and Community Affairs (TDHCA) current administration and enforcement of labor standards is acceptable.

If you have any questions, concerns or need additional information regarding labor standards activities, you can contact Joyce F. Ingram, Labor Relations Specialist, at 817.978.5622 or via email at joyce.f.ingram.hud.gov.

Sincerely,

Jerlinda D. Banks
Regional Labor Relations Officer



March 3, 2011

Department of Energy

Golden Field Office
1617 Cole Boulevard
Golden, Colorado 80401-3393

RECEIVED
MAR 08 2011

EXECUTIVE DIRECTOR

Mr. Michael Gerber
Executive Director,
Texas Department of Housing and Community Affairs
221 East 11th Street
P.O. Box 13941
Austin, Texas 78711-3941

RECEIVED
MAR 08 2011

ENERGY ASSISTANCE

Subject: DOE On-site Monitoring Report of Texas Weatherization Assistance Program

Dear Mr. Gerber,

On February 14th through February 18th, 2011, Paul Jiacoletti, and Carl Saueressig, Project Officers with the United States Department of Energy Golden Field Office, conducted an on-site monitoring assessment of the State of Texas Weatherization Assistance Program. Attached is a report on the results of the visit.

The monitoring assessment included a review of administrative, financial and programmatic aspects of the Texas WAP, as well as a visit to two sub grantee agencies. Please find enclosed the DOE Monitoring Report, which summarizes findings, observations and recommendations and required follow-up actions as a result of the monitoring visit. Please submit a response within the next 15 days indicating what follow-up actions will be taken as a result of this visit and report. Please note that there are no findings cited during the visit.

Please contact Mr. Jiacoletti or Mr. Saueressig if you have any questions or concerns about this report. We may be reached at paul.jiacoletti@go.doe.gov (720-356-1632) and carl.saueressig@go.doe.gov (720-356-1597) respectively.

We look forward to continued interaction with you and your staff in the effective implementation and operation of the Weatherization Assistance Program.

Thank you for the cooperation and assistance your staff provided during the visit.

Sincerely,

Robert L. DeSoto
Branch Chief

cc: Michael DeYoung, TDHCA
Kellyn Cassell, NETL
Georgeann St. Clair, NETL
Paul Jiacoletti, DOE
Holly Ravesloot, DOE



U.S. Department of Energy 2009 American Reinvestment and Recovery Act (ARRA)



**Office of Energy Efficiency and Renewable Energy
Weatherization and Intergovernmental Program**

**To: Michael Gerber, Executive Director
Texas Department of Housing and Community
Affairs**

**From: Paul Jiacoletti, Carl Saueressig
Weatherization, Golden Field Office
1617 Cole Boulevard
Golden, Colorado 80401**

**On-site Monitoring Report for State of Texas
Grant Award DE-EE0000094
Dates of Visit: February 14th through 18th, 2011**

February 25, 2011

1 Participants

Department of Energy

Paul Jiacoletti	Department of Energy – Project Officer	720 356-1632
Carl Saueressig	Department of Energy – Project Officer	720 356-1597

Texas Department of Housing and Community Affairs

Sandy Donoho	TDHCA – Director of Internal Audit	512 475-3813
Marco Cruz	TDHCA - Project Manager, Training	512 475-3860
Alfredo Mycue	TDHCA – Training Officer	512 475-3860
Brenda Hull	TDHCA – Office of Recovery Act	512 305-9038
Brooke Boston	TDHCA – Deputy Executive Director	512 475-1762
Tim Irvine	TDHCA – Chief of Staff/General Counsel	512 475-3296
Nicole Elizondo	TDHCA – Internal Audit	512 936-7821
Ann Miller	TDHCA – Energy Assistance Quality Analyst	512 936-7802
Cathy Collingsworth	TDHCA – Project Manager Financial Reporting	512 475-3858
Esther Ku	TDHCA – Accounting Manager	512 475-3871
Sharon Gamble	TDHCA – Energy Assistance Manager	512 475-0471
Michael DeYoung	TDHCA – Director – Community Affairs	512 475-2125
David Cervantes	TDHCA – CFO – Financial Administration	512 475-3875
David Johnson	TDHCA – Recovery Act Specialist	512 936-7828

2 Executive Summary

The purpose of this monitoring trip was to monitor the awards made under the DOE Weatherization Assistance Program (WAP) which includes the "regular" annual WAP award, and the award under the American Recovery and Rehabilitation Act. The visit took place at the offices of the Texas Department of Housing and Community Affairs in Austin, Texas. There are several items which were discussed during the trip, some of which were discussed during previous monitoring visits and needed further follow-up. This visit resulted in no findings; however there are some concerns which if not properly addressed in the future may result in findings during subsequent trips. The Department of Energy would appreciate a response from the Grantee within 30 days of receipt of this report.

- The first item which was discussed late Monday afternoon of the first day was the grantee's desire for more information regarding the possible purchase of an insurance policy to pay for potential ramp down costs associated with layoffs at the end of the ARRA program. The grantee forwarded questions which will require research. When the solutions are identified the answers will be forwarded to the grantee.
- The second item which was discussed during the afternoon was the development of a spreadsheet tool by David Johnson, Recovery Act Specialist, which outlines the expenditures and production totals to date and the per-unit averages of the sub-grantee network. This tool forecasts the expected production and expenditure totals based on existing spend and production rates for each sub-grantee with results shown for August and December of this year and the final expected production and expense numbers for the end of the program in March of 2012. This tool is designed to identify the effect of changes if funds are re-obligated to higher producing grantees and production quotas are raised in order to ensure full expenditure of the grant funds. This tracking mechanism allows TDHCA to forecast the results of moving funding from slower producing agencies to higher producing agencies within the state.

- The Project Officers conducted a formal entrance interview with Grantee staff on Tuesday morning, April 15th. During the entrance interview, Paul Jiacoletti, DOE Project Officer thanked the grantee staff for their courtesy and help and outlined what the Project Officers would be reviewing during this monitoring visit. Mr. Jiacoletti also discussed the monitoring schedule for the coming year, coupled with the Quality Assurance visits. Msrs. Jiacoletti and Saueressig explained briefly what the process would be for the Institute for Building Technology and Safety (IBTS) visits to the state.
- Mr. Jiacoletti requested documentation demonstrating that previous findings on two monitoring trips had been addressed and were resolved. This information was provided on this monitoring trip and these findings are resolved to the satisfaction of the Project Officer.
- A request was made of Mr. Michael DeYoung to provide a room for a conference call with the financial personnel from the National Energy Technology Laboratory to conduct fiscal desk monitoring of the Weatherization Program for ARRA in Texas. The grantee graciously provided a room. The Department of Energy Project Officers would like to thank Ms. Esther Ku and Mr. David Cervantes for taking time from their busy schedules during the state budget period to participate in this call.
- The Project Officers spent time reviewing Davis-Bacon procedures and payrolls Tuesday morning. The Project Officers interviewed two Federal Labor Standards Specialists, Ms. Julie Hartley and Ms. Angelique Naylor who provided information on the submittal and review of Davis-Bacon certified payrolls.
- Paul Jiacoletti discussed the submittal of financial reports for the ARRA grant, specifically the SF425 (Financial Report) and the Quarterly and Monthly Performance Reports. These had been "rejected" numerous times at the request of the Grantee to provide an opportunity to correct reported numbers. The Project Officers indicated that time should be set aside to discuss, correct and approve these reports during the visit. The corrections have not been done and the reports are still "rejected".
- Mr. Jiacoletti and Mr. Saueressig asked to review the monitoring tool which has been in use for the past year. Mr. Stephen Jung provided copies of the monitoring instrument in addition to the schedule and a risk assessment tool which was developed to address an identified need to spend additional time with "at risk" grantees who are in danger of being de-obligated by TDHCA for non-performance. The requested copies were provided by Mr. Jung who was ill, but responded to our requests. We wish to thank him for this effort. It was greatly appreciated and helped our review of this very important part of the program.
- The Project Officers visited the Hill Country Community Action Agency in San Saba, Texas. We performed file review, answered questions from sub-grantee staff, obtained a copy of the inventory for vehicles and equipment and visited completed and in-process units in Gatesville, Texas. This field visit also provided an opportunity to see how the State of Texas monitors its sub-grantee agencies for weatherization and gave the DOE Project Officers a chance to discuss weatherization issues with the sub-grantee field staff.

3 Financial Review

A financial desk review via conference call was scheduled with the National Energy Technology Laboratory. The Contracting Officer is responsible for monitoring DOE Weatherization grantees for financial compliance against Federal Regulations and Grantees policies and procedures. A conference room was supplied by the Grantee for this purpose and attended by the Project Officers, Mr. Michael DeYoung, Ms. Sharon Gamble, Ms. Esther Ku and Mr. David Cervantes of the Texas Department of Housing and Community Affairs. A copy of the financial monitoring tool was provided for use by Ms. Georganne Saint Clair. Ms. Lisa Kuzniar was also available for this call. After some discussion amongst the NETL representatives, it was decided that a desk review was unnecessary due to completion and submittal of the financial report in October of the previous year. The report identified no findings or areas of financial concern for the grantee. It is greatly appreciated by DOE that Ms. Ku and Mr. Cervantes took the time to attend and potentially answer questions especially in view of their responsibilities to contribute information for the state budgeting process which was taking place during this monitoring visit.

It was decided during the call that a more thorough review of the Grantee's financial management will be performed by NETL personnel during the latter part of this year. The results of the desk monitoring will be shared with the grantee when they become available.

4 Administrative Review – Award File and Personnel Review

A review of personnel who are on staff to administer the grant for the State of Texas confirms that there have been no changes in key personnel listed in the State plan. All personnel in the state plan are performing the functions outlined by that document.

A review of the Davis-Bacon procedures was performed by the Project Officers. Julie Hartley and Angelique Naylor, Federal Labor Standards Specialists, were interviewed to ascertain that proper oversight is being maintained for certified payrolls submitted in conjunction with Davis-Bacon payments in the weatherization program. They were able to demonstrate the following:

- The process for verifying the accuracy of the certified payrolls,
- The procedure for dealing with needed corrections on these payrolls, including generating and issuing letters to contractors for needed corrections
- The correct use of the approved wage determinations,
- Proper withholding based on documented
- Data entry into an ACCESS system to track and compute payments and provide checks and balances for accuracy of all of the above,
- Use of the ACCESS system to generate letters to the contractor for corrections
- Use of an Outlook "tickler file" to track response times for corrections
- Location of the files for hard copies of all Davis-Bacon payrolls

When requested, copies were provided of the desk review checklist used on a daily basis, the monitoring instrument used for field monitoring of Davis-Bacon contractors, a hard copy of the Labor Standards for the ARRA and WAP Program complete with the Standard Operating Procedures and a single page copy from the ACCESS database of deficiencies which were found and are being updated when information is received. The Davis-Bacon requirements appear to follow established procedures.

The Project Officers requested and received copies of the monitoring instrument. When questioned, Stephen Jung responded to the Program Officer's queries about the Risk Assessment tool, which is designed to identify struggling agencies in conjunction with on site monitoring results. When these agencies are identified they are ranked in order of risk and provided additional visits which can be used to monitor performance, provide additional on-site Training and Technical Assistance and help the sub-grantee agency overcome the deficiencies which are preventing them from achieving their contractual milestones. This is a response to an identified concern by the Department of Energy Project Officers in previous monitoring trips and arises from a technical assistance suggestion to utilize the monitoring results to identify agency problems and provide additional training and assistance to help salvage struggling agencies rather than de-obligating them and placing an additional burden on adjacent agencies which may be struggling themselves.

A copy of the monitoring manual was supplied to the Project Officers by Mr. Jung for our review. The manual is designed to provide a guide for monitoring personnel for the state. It explains all the processes and procedures and intent of the monitoring role, outlines guidance for findings and concerns, how to write and submit monitoring reports, documentation of results which provide information which can be used to help Texas manage deficiencies in its weatherization sub-grantee network. The monitoring manual appears to be comprehensive, is capable of identifying deficiencies which exist between identified measures and installed measures, addresses the financial, programmatic and administrative review requirements of the sub-grantee agency, addresses both Davis-Bacon and Historic Preservation requirements, provides a mechanism to ascertain inventory and equipment on site matches with the

master inventory list, identifies the procedures required for ongoing findings, and in general provides a template for monitoring behavior and reporting which allows identification of any deficiencies in the sub-grantee agency which must be corrected.

4.1 Issues and Concerns

Concern#1: The Department of Energy and the Project Officers would like to see the risk-assessment tool used to emphasize and improve the quality of the weatherization effort in units statewide. Our concern stems from the fact that previous monitoring trips have not identified consistent quality in agencies we have visited. The additional training based on monitoring results and the risk assessment provides a chance to identify areas of improvement and should improve the quality of the weatherization effort in all agencies.

Action Item #1: The number of additional visits identified by the risk assessment tool provides ample opportunity to continue to address issues of quality installation on site, completeness of audit information, efficacy of the assessment and a true measure of whether the whole house assessment has accomplished its purpose. It also provides opportunities to remove the need for "call backs" to correct work prior to reporting completed units. This is consistent with and in the spirit of, Weatherization Program Notice 11-3. The Department of Energy would like TDHCA to consider making technical assistance a greater part of future monitoring to ensure consistently higher quality statewide. DOE would also like to see on future monitoring visits, thorough final inspections of the weatherization effort to ensure there are limited returns for corrections throughout the State.

Concern #2: The Department of Energy identified a concern in the last monitoring report concerning the achievement of identified goals for production and expenditures with the regular DOE grant. Our concern was based on reports in the PAGE system which indicated that the State of Texas would fall short of achieving its stated goals in the state plan. The Grantee has been told that ARRA and the Formula DOE grant run concurrently and that production and costing for both grants must be achieved. We are concerned that continued weatherization funding may be based on demonstrated need. Large amounts of carryover from grant year to grant year are perceived by Congress as a failure to perform under the grant and as such could limit funding in future years.

Action Item #2: The Project Officers again request a production/expense spreadsheet for the 2011-2012 formula DOE grant. We recognize that this is not a program requirement; however we feel it could be a useful tool for tracking production and expenditures and could allow us to provide better support to the Texas Weatherization program based on our knowledge of other state programs which are producing under both grants.

5 Programmatic Review

The State of Texas identified "at risk" sub-grantees in previous monitoring trips and in their responses from the Energy Assistance Manager, Sharon Gamble for this visit. The number of agencies which are struggling in the state is dwindling. A list of these agencies and the actions taken by the grantee are listed below.

Name of Agency	Reason for "at risk" status	Result
City of Brownsville	Lack of organizational controls	Contract suspended: Intensive Training and Technical Assistance

Community Services Agency of South Texas	Lack of organizational controls	Melliora, cost reimbursement – Notified of intent to de-obligate funds
Tri-County Community Action Agency	Lack of organizational controls	Melliora, cost reimbursement – Notified of intent to de-obligate funds
Webb County Community Action Agency	Lack of organizational controls suspected waste, fraud and abuse	Contract suspended – Deobligated funds for both ARRA and DOE formula grant

The Texas Department of Housing and Community Affairs has demonstrated a positive response to the concerns outlined in previous monitoring reports and especially the fourth visit of 2010. The development of tracking tools such as the risk analysis associated with monitoring visits, the spreadsheet to track and identify opportunities to move funding to stronger agencies within the state, the development of a Program Operations class for agency managers to help them understand, identify and track program performance and the intensive "NEAT blitz" designed to provide training in the use of the audit tool are commendable.

The Project Officers visited the Hill Country Community Action Agency, a sub-grantee with the State of Texas to review files and monitor the State's inspector who conducted final inspections of two completed units in Gatesville, Texas. The Project Monitors expressed a desire to see in-progress units and completed units. The Grantee complied with this request; however both in-progress units are undergoing Lead Safe Weatherization measures associated with window replacement and dense-pack insulation installation which precluded inspection by the Project Officers because we could not enter the containment area. A listing of the properties visited is shown in the table below, complete with some properties which were not visited due to time constraints, but had file review done by the Project Officers.

Table 1: Properties Visited During DOE On-Site Monitoring

Job No.	Dwelling Type	City/State	Weatherization Status
Job #41507	Single Family	Gatesville, Texas	In-Progress
Job #22044	Single Family	Gatesville, Texas	Final Inspection
Job #56401	Single Family	Gatesville, Texas	Final Inspection
Job #56605	Single Family	Gatesville	File Review Only
Job #50685	Single Family	San Saba	File Review Only
Job #56204	Single Family	San Saba	File Review Only

The Project Officers noted that windows were being replaced in the units we visited. This required the testing of those properties for lead paint, containment in those areas where exposure to dust existed and additional costs associated with both. The windows "ranked" based on the results of the EASY2 audit. This audit was used for the assessment prior to the January 31st, 2011 cutoff date by the State of Texas. The number of window replacements is a concern to the Project Officers and the Grantee. This issue is being resolved by the implementation of the NEAT/MHEA audit coupled with an intensive training regimen to assure the weatherization network concentrates on ranked weatherization measures to achieve a whole house approach to weatherization which will result in identified energy savings in the future. This is not listed as a concern at this time, due to the pro-

active implementation by TDHCA of the NEAT/MHEA audit and the associated training being provided to the sub-grantee network. However, DOE would caution the grantee that if this practice continues with the approved use of the NEAT/MHEA audit, this will rise to the level of a finding if audits are not conducted accurately and appropriately in the future. This will be closely monitored on the next visit.

The Project Officers would like to commend Hill Country CAA on the completeness of their client files. The quality of work is acceptable for this agency for the weatherization effort. The sub-grantee staff was cordial and accommodated the Project Officers requests for information and documentation.

Previous monitoring reports dated August 24th and December 14th have been responded to by the Grantee and those responses have been forwarded to DOE for our review. Both of these monitoring reports contained "findings" which have been addressed and the results listed below.

Finding #1: "The sub-recipients must ensure that the audit analyzes all allowable measures as stated in the state plan and ranks them appropriately to ensure that clients receive the full range of weatherization measures."

The Texas Department of Housing and Community Affairs (grantee) instituted the use of the NEAT/MHEA audit tool in December with the caveat to their network that no audits were to be run with any other tool after January 31st of 2011. The use of the EASY2 audit which was run for this assessment is being discontinued. In addition, to assure the correct use of this audit tool, TDHCA has implemented training in the proper use of the audit to ensure measures are identified and ranked properly and the whole house weatherization goal to achieve the greatest energy efficiency is attained. This finding is resolved to the satisfaction of the Project Officer with the caveat that future monitoring trips will include a close look at the efficacy of the audit tool to ensure that clients receive the full benefit of the program.

Finding #2: "The payment to a contractor for a window which was not installed constitutes a finding and is fraudulent because the program reimbursed a contractor for reported expenses on a measure which was not installed."

This finding is resolved to the satisfaction of the Project Officer. TDHCA disallowed this cost and required the sub-recipient to provide evidence of payment from a non-federal source of funds in order to reimburse the program. This has been done and copies of the check, the deposit, and the ledger entries to reverse the previous payment and post the new payment have all been provided to the Department of Energy Project Officer. In addition, the sub-grantee response indicates that future inspections will entail a more thorough and comprehensive examination of the measures identified for installation on the Building Weatherization Record and the validation that those measures have in fact been installed, prior to payment of invoices.

In addition, the concerns identified in the initial monitoring report have been addressed.

The monitoring report dated December 14th contained two findings.

Finding #1: "The NEAT audit was run improperly. Measures were ranked which would not ordinarily rank with proper, accurate input used in the audit. The replacement of HVAC units ranked because the electric "whip" and a concrete pad were moved to the Health and Safety portion of the audit."

Finding #2: "An HVAC unit was replaced at COA-0169/1. The existing unit was thought to be a 1.5 ton unit. It was replaced with a 2 ton unit but the program was charged \$3,578 for a 2.5 ton unit."

The first finding is resolved due to the intensive training ("NEAT" blitz training) which was provided to both the City of Austin and Travis County Health and Human Services (both agencies are in Austin, Texas) to resolve the misconception that moving parts of the assessment to the Health and Safety portion of the audit is an acceptable practice. The grantee stated in their response that costs have been disallowed. This will require re-payment by the sub-grantee of the costs associated with an unranked replacement of a heating and cooling unit. The identification by TDHCA in their monitoring reports of further abuses of HVAC replacements and their efforts to ensure audits are run appropriately combined with disallowed costs provides satisfactory evidence that the findings are resolved. The Grantee should understand that this will continue to be an ongoing source of investigation at all sub-grantee agencies to ascertain that audits are being run appropriately.

Issue/Concern	Recommended Corrective Action
<p>1) The use of the NEAT/MHEA energy audit must be done correctly. This should result in the proper identification of measures with a ranking of one or greater and provide a "whole house" ranking of one or greater for the TOTAL of the ranked measures also.</p>	<p>1/ Continue to provide the NEAT blitz as outlined to the Project Officers during this monitoring visit.</p> <p>2/ Continue to emphasize and enforce proper use of the audit in state monitoring and inspection trips. Identify and target those agencies who require more training and technical assistance on the proper use of the audit and ensure they receive this assistance as soon as possible. Document the effort with your training group to track whether repeat training has been done or continue to be necessary. Continued abuse of the audit should be a "finding" in the state monitoring reports and as such, addressed appropriately.</p>
<p>2) The Department of Energy has a concern that the approval for the NEAT/MHEA submittal be in place by the 31st of March of this year.</p>	<p>Continue to discuss required submittal information with DOE to ensure that all required information is provided. Submit any additional requested documentation as soon as possible to expedite approval of this audit tool.</p>
<p>3) The Grantee has submitted a TREAT multi-family audit packet for approval by DOE for use in their weatherization program.</p>	<p>Continue to discuss with DOE any requested additional documentation necessary for approval of this audit.</p>

6 Technical Assistance

The Project Officers participated in a TACAA (Texas Association of Community Action Agencies) meeting with the sub-grantee network in Austin, which provided an opportunity for the Project Officers to answer questions, address concerns and provide some Technical Assistance for the

Weatherization Program. This was done in conjunction with the Grantee staff and allowed the Project Officers to interact with agency personnel and address their concerns regarding the Texas Weatherization program. It also provided an opportunity to meet sub-grantee agency personnel who we may be interacting with on Quality Assurance trips this year.

Carl Saueressig was invited to accompany Marco Cruz and Alfredo Mycue from the training arm of TDHCA to a multi-family site in Austin, Texas which is presently being rehabilitated with tax increment funds. This building will also receive weatherization measures. Mr. Saueressig provided Technical Assistance on the allowability of costs, the need and methodology to identify and properly rank measures in the building in order to assure the best weatherization outcome and reminded the engineers present to remember to calculate costs for both heating and cooling systems, air infiltration (via blower door) and base load measures to provide the "whole house" weatherization required by the program.

7 Promising Practices

The Texas Department of Housing and Community Development has developed and instituted a course of instruction in Program Operations which provides Program Managers and Executive Directors with a tool to forecast and track production expenditures and output, understand the reasons for delayed output or expenditures, and craft measurable solutions which ensure that agencies who are falling behind in production and expenditures are able to get back on track and achieve their contractual goals and responsibilities. This is a response to a need identified by DOE Project Officers to provide Training and Technical Assistance to "at risk" agencies in need of additional help and in danger of having their program de-obligated by the Grantee. There are 13 months left in the ARRA grant period which does not provide sufficient time to train new agencies to perform weatherization work at the levels necessary to assure program success. The experienced agencies who are struggling but can be salvaged with an increased Training and Technical Assistance effort will show measurable progress sooner than could be expected with new agencies. This improvement in performance should also reduce the number of de-obligated agencies, ensure services can be provided state-wide and remove pressure from adjacent agencies to assume responsibility for the weatherization effort in those areas they serve.

Texas is using a risk assessment tool in conjunction with agencies that are under performing to identify potential failure and incorporate additional monitoring visits which provide additional training and technical assistance to those agencies which are not meeting their identified weatherization goals under the ARRA grant. This is another facet of the response developed by the grantee to identify and rank agencies that are struggling and need direction to assure their success in the statewide weatherization program. It is also in compliance with the guidance found in Weatherization Program Notice 10-9. The ranking of sub-grantees based on monitoring report data, performance in terms of expenditures and production, quality of weatherization product, timeliness of reporting, fiscal performance, etc. allows TDHCA to know at a glance which agencies require additional effort in terms of guidance, training and assistance. This in turn generates additional visits to these agencies. This effort is designed to help existing agencies rather than de-obligate them which may place greater pressure on adjacent agencies to produce and expend more to meet the statewide weatherization commitment. The lack of qualified responders to RFA's and the shortened time line for training new agencies with questionable probability of success demands that the grantee utilize this extra effort to achieve the success they indicated in their state plan.

Texas has discussed with DOE Project Officers a desire to move ARRA grant funding to different agencies in the state who have demonstrated they can administer grant funds capably and meet or exceed the requirements identified in their weatherization contracts with the state. Texas maintains this will allow full expenditure of the ARRA grant funding while leaving no area of the state unserved. The existing weatherization contracts in the state will expire as of August 31st of this year and will provide an opportunity to either extend or renew contracts with an increase in funding and

production requirements. The re-allocation of funding to stronger agencies in the state allows Texas to fully expend grant funds and achieve their weatherization milestones in terms of production. This strategy provides the grantee with an alternative to total de-obligation of funding for any agency and allows smaller agencies to provide weatherization benefits in their area of responsibility which are more closely aligned with their capabilities. In order to identify those agencies that are satisfactorily expending funds and fulfilling their production requirements, a spreadsheet was developed by David Johnson the Recovery Act Specialist, which provides analysis of the entire sub-grantee network and their performance. The spreadsheet provides a capability to forecast the effects of changes in monetary and production commitments should funds be re-obligated to different agencies in differing amounts. This spreadsheet will assist in providing insight into the best use of the funding during the final six months of the ARRA grant by identifying those agencies which have demonstrated a capability for producing weatherized units and expending funds responsibly and who can continue to do so during the remainder of the ARRA grant period.

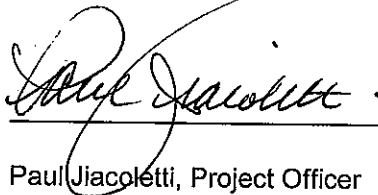
8 Conclusion

The Grantee has demonstrated their willingness to develop and incorporate process changes in their administration of the Weatherization Program to achieve the goals identified in their state plan. The changes must be implemented as soon as possible to provide needed quality in the weatherization effort statewide. The major areas of concern for the Department of Energy are the correct use and implementation by March 31st of an **approved audit tool** for single family and manufactured homes, an emphasis on the use of engineering studies to identify and rank measures for multi-family projects during the remainder of the ARRA grant period, the continued interaction between the training arm and monitoring personnel to identify opportunities to provide needed Training and Technical Assistance for improvement of the quality of the weatherization effort at the sub-grantee level and finally, the capability of DOE to review accurate and timely reporting information in the PAGE system on a monthly, quarterly and annual basis for the ARRA grant.

9 Certification

We have conducted this monitoring visit in accordance with DOE standard procedures using the appropriate monitoring checklists for the purpose of forming an opinion on the general administration of the grant.

Report Prepared by:



Paul Giacoletti, Project Officer

3/3/11

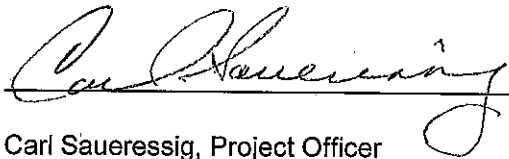
Date

Weatherization Assistance Program

U.S. Department of Energy

Golden Field Office, 1617 Cole Boulevard, Golden, CO 80401

Report Prepared by:



Carl Saueressig, Project Officer

3/3/11

Date

Weatherization Assistance Program

U.S. Department of Energy

Golden Field Office, 1617 Cole Boulevard, Golden, CO 80401

Report Reviewed by:



Robert L. DeSoto

3/4/11

Date

Branch Chief

Weatherization Assistance Program

Golden Field Office



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April 8, 2011

Mr. Robert DeSoto
Branch Chief
Weatherization Assistance Program
Golden Field Office
1617 Cole Boulevard
Golden, CO 80401

Dear Mr. DeSoto:

The Texas Department of Housing and Community Affairs (the Department or TDHCA) is in receipt of your monitoring report dated March 3, 2011. The Department provides the following responses to address the issues and concerns contained in the report:

Concern #1: The Department of Energy and the Project Officers would like to see the risk assessment tool used to emphasize and improve the quality of the weatherization effort in units statewide. Our concern stems from the fact that previous monitoring trips have not identified consistent quality in agencies we have visited. The additional training based on monitoring results and the risk assessment provides a chance to identify areas of improvement and should improve the quality of the weatherization effort in all agencies.

Action Item #1: The number of additional visits identified by the risk assessment tool provides ample opportunity to continue to address issues of quality installation on site, completeness of audit information, efficacy of the assessment and a true measure of whether the whole house assessment has accomplished its purpose. It also provides opportunities to remove the need for "call backs" to correct work prior to reporting completed units. This is consistent with and in the spirit of Weatherization Program Notice 11-3. The Department of Energy would like TDHCA to consider making technical assistance a greater part of future monitoring to ensure consistently higher quality statewide. DOE would also like to see on future monitoring visits, thorough final

inspections of the weatherization effort to ensure there are limited returns for corrections throughout the State.

TDHCA Response: The Department is actively implementing processes to make technical assistance a greater part of future monitoring to ensure consistently higher quality statewide. Specifically, our actions include:

- Posting of Best Practices documents to our website to assist Subgrantees in all phases of program planning. As the Best Practices documents are developed, they are posted on our program website at <http://www.tdhca.state.tx.us/ea/wap.htm#bestpractices>;
- Subrecipient-specific training and technical assistance opportunities provided by our training academy;
- NEAT Blitz audit proficiency assessments to ensure that Subrecipient staff understands the audit tool;
- Database tracking of findings by type and frequency on a network-wide level and Subrecipient level, allowing for trend-based training design; and
- Addition of a "Training Recommendations" section to our monitoring reports to allow the monitor to relay information about training needs observed during a monitoring visit both to the Subgrantee and to the Department's training staff in an official document. Training Recommendations and their outcomes will be tracked in using the database mentioned above.

Concern #2: The Department of Energy identified a concern in the last monitoring report concerning the achievement of identified goals for production and expenditures with the regular DOE grant. Our concern was based on reports in the PAGE system which indicated that the State of Texas would fall short of achieving its stated goals in the state plan. The Grantee has been told that ARRA and the Formula DOE grant run concurrently and that production and costing for both grants must be achieved. We are concerned that continued weatherization funding may be based on demonstrated need. Large amounts of carryover from grant year to grant year are perceived by Congress as a failure to perform under the grant and as such could limit funding in future years.

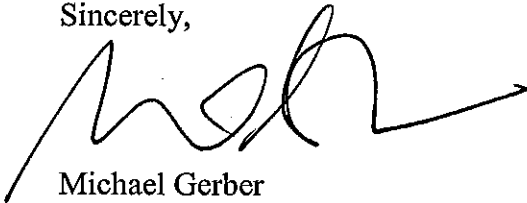
Action Item #2: The Project Officers again request a production/expense spreadsheet for the 2011-2012 formula DOE grant. We recognize that this is not a program requirement; however, we believe it could be a useful tool for tracking production and expenditures and could allow us to provide better support to the Texas Weatherization program based on our knowledge of other state programs which are producing under both programs.

TDHCA Response: Since funding allocations for the 2011-2012 DOE Formula Grant have not yet been announced, in providing this information, the Department has assumed level funding

from the 2010-2011 DOE Formula Grant. Attachment A includes funding levels and production forecasts, based on this assumption.

The State of Texas appreciates the review and assessment of the Texas WAP program by the Department of Energy staff. As noted in your report, we have acted to encompass the insight and technical assistance you have provided during your visits. We continue to refine our processes where needed and are focusing on increased expenditures per unit, increased unit quality, and consistency in the performance of our Subgrantees, actions which will help to ensure the full expenditure of the ARRA funds, and provide the low-income residents of the State of Texas the energy efficiency measures they deserve.

Sincerely,

A handwritten signature in black ink, appearing to read 'Michael Gerber', with a long horizontal stroke extending to the right.

Michael Gerber
Executive Director

Sdg

Cc: Paul Jiacoletti
Carl Saueressig
Michael De Young

2011-2012 DOE Formula Grant Expense and Production Projections

Subrecipient	DOE admin	Liability Insurance	Pollution Insurance	Audit	Health & Safety	Mat/Lab/PS	Total Program \$	Travel	Total w/Travel	# of units
Alamo ACOG	29,334	2,000	11,436	800	49,955	199,819	293,344	2,000	295,344	31
Bee CAA	2,065	2,000	805	800	2,996	11,983	20,649	2,000	22,649	2
Big Bend Community Action Committee, Inc.	4,591	2,000	1,790	800	7,346	29,384	45,911	2,000	47,911	5
Brazos Valley Community Action Agency, Inc.	11,998	2,000	4,678	800	20,101	80,406	119,983	2,000	121,983	13
Cameron and Willacy Counties Community Projects, Inc.	10,453	2,000	4,075	800	17,440	69,757	104,525	2,000	106,525	11
City of Lubbock	4,933	2,000	1,923	800	7,934	31,738	49,328	2,000	51,328	5
Combined Community Action, Inc	6,802	2,000	2,652	800	11,153	44,612	68,019	2,000	70,019	7
Community Action Committee of Victoria	9,461	2,000	3,688	800	15,732	62,927	94,608	2,000	96,608	10
Community Action Corp. of South Texas	21,986	2,000	8,571	800	37,301	149,206	219,864	2,000	221,864	23
Community Action Program, Inc.	8,128	2,000	3,169	800	13,437	53,749	81,283	2,000	83,283	9
Community Council of Reeves County	1,379	2,000	537	800	1,814	7,256	13,786	2,000	15,786	1
Community Services Agency of South Texas, Inc.	7,257	2,000	2,829	800	11,937	47,751	72,574	2,000	74,574	8
Community Services, Inc.	19,673	2,000	7,670	800	33,318	133,273	196,734	2,000	198,734	21
Concho Valley Community Action Agency	7,125	2,000	2,777	800	11,709	46,835	71,246	2,000	73,246	8
Dallas County Department of Health and Human Services	27,208	2,000	10,607	800	46,292	185,170	272,077	2,000	274,077	29
Economic Opportunities Advancement Corporation of PR XI	7,493	2,000	2,921	800	12,342	49,370	74,926	2,000	76,926	8
El Paso Community Action Program, Project Bravo, Inc.	14,566	2,000	5,678	800	24,523	98,092	145,659	2,000	147,659	15
Fort Worth, City of, Department of Housing	15,285	2,000	5,959	800	25,761	103,044	152,849	2,000	154,849	16
Greater East Texas Community Action Program (GETCAP)	11,665	2,000	4,548	800	19,528	78,111	116,652	2,000	118,652	12
Hill Country Community Action Association, Inc.	8,782	2,000	3,424	800	14,563	58,249	87,818	2,000	89,818	9
Institute of Rural Development, Inc.	668	2,000	260	800	590	2,358	6,676	2,000	8,676	1
Nueces County Community Action Agency	6,205	2,000	2,419	800	10,126	40,504	62,054	2,000	64,054	7
Panhandle Community Services	12,353	2,000	4,816	800	20,713	82,850	123,532	2,000	125,532	13
Programs for Human Services, Inc	12,784	2,000	4,984	800	21,455	85,820	127,843	2,000	129,843	14
Rolling Plains Management Corporation	6,515	2,000	2,540	800	10,658	42,632	65,145	2,000	67,145	7
Shelkering Arms, Inc.	22,647	2,000	17,658	800	81,966	327,866	452,937	2,000	454,937	51
South Plains Community Action Association	6,755	2,000	2,633	800	11,072	44,290	67,550	2,000	69,550	7
South Texas Development Council	3,472	2,000	1,354	800	5,420	21,678	34,724	2,000	36,724	4
Texoma Council of Governments	11,899	2,000	4,639	800	19,931	79,723	118,992	2,000	120,992	13
Travis County	9,167	2,000	3,574	800	15,226	60,905	91,672	2,000	93,672	10
Tri-County Community Action, Inc	6,858	2,000	2,674	800	11,250	44,998	68,580	2,000	70,580	7
Webb County Community Action Agency	4,691	2,000	1,829	800	7,518	30,073	46,911	2,000	48,911	5
West Texas Opportunities, Inc.	9,934	2,000	3,873	800	16,547	66,187	99,341	2,000	101,341	11
	344,132	66,000	142,990	26,400	617,654	2,470,616	3,667,792	66,000	3,733,792	393



Issue Date January 26, 2011

Audit Report Number 2011-FW-1006

TO: Yolanda Chavez, Deputy Assistant Secretary for Grant Programs, DG

//signed//

FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The Texas Department of Housing and Community Affairs Generally Ensured
That Its Program Management Firm Complied With Requirements

HIGHLIGHTS

What We Audited and Why

We audited the U. S. Department of Housing and Urban Development (HUD) Community Development Block Grant (CDBG), Supplemental II Disaster Recovery program funds, administered by the Texas Department of Housing and Community Affairs (TDHCA). Specifically, we wanted to determine whether TDHCA monitored its program management firm¹ (the Firm) to ensure compliance with Federal and State regulations and to ensure costs reimbursed for the Housing Assistance Program (HAP) and the Sabine Pass Restoration Program (SPRP) were adequately supported. This is the fourth audit of the Disaster Recovery funds awarded to the State of Texas, and it was conducted as part of the Office of Inspector General's (OIG) commitment to HUD to implement oversight of Disaster Recovery funds to prevent fraud, waste, and abuse.

¹ ACS State and Local Solutions, Inc.

What We Found

TDHCA's monitoring activities provided assurance that the Firm generally complied with Federal and State regulations. Further, TDHCA's reviews and monitoring generally ensured that program costs submitted for reimbursement by the Firm were adequately supported. However in a minor instance of noncompliance, TDHCA allowed the Firm to budget and receive reimbursement for a \$71,691 mark-up for "Admin Fees on Subcontractors" calculated using a "cost plus a percentage of cost method" that is not allowed under CDBG rules. TDHCA had originally questioned the costs but subsequently allowed them because contractor staff provided support that made the expenditures seem plausible to TDHCA.

What We Recommend

We recommend that HUD's Deputy Assistance Secretary for Grant Programs require TDHCA to recover from the Firm all "Admin Fees on Subcontractors" costs, reimburse its HUD Disaster Recovery program accounts for those costs, and continue to monitor and review program disbursements for the ineligible cost plus a percentage of cost payments.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided TDHCA our draft report on January 4, 2011, and requested its comments by January 20, 2011. We held an exit conference on January 18, 2011, with TDHCA and HUD. TDHCA provided its response to the draft report on January 19, 2011. It generally concurred. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Congress authorized two supplemental funding appropriations to assist the Gulf Coast States in recovering from the destruction of Hurricanes Katrina, Rita, and Wilma. Public Law 109-148 authorized \$11.5 billion (Supplemental I), and Public Law 109-234 (Supplemental II) authorized \$5.2 billion in Disaster Recovery program funding. Of the \$16.7 billion, the State of Texas (State) received \$503 million through the U. S. Department of Housing and Urban Development (HUD) Community Development Block Grant (CDBG) program to address areas most impacted by Hurricanes Rita and Katrina.

The Governor of Texas selected the Texas Department of Housing and Community Affairs (TDHCA) as the lead agency to administer the Disaster Recovery funds. TDHCA was established in 1991 as the State's primary agency to provide essential public service and housing needs for extremely low to moderate income individuals and families in Texas. TDHCA in conjunction with the State's Council of Governments distributed the Supplemental I funds for housing. TDHCA allocated \$232 million in Supplemental II funds to aid eligible homeowners to repair or replace their hurricane damaged homes. The Supplemental II funds were distributed for housing using a procured program management firm (Firm).

In December 2007, TDHCA contracted with the Firm, which subcontracted with Shaw Environmental, Inc. (Shaw), and Reznick, Mississippi, L.L.C. (Reznick), to administer the Housing Assistance Program (HAP) and the Sabine Pass Restoration Program (SPRP). The Firm was to be responsible for the distribution of \$232 million in Supplemental II housing aid to homeowners affected by the hurricanes. As of September 2010, the Firm reported that it had constructed or rehabilitated more than 2,000 homes with Supplemental II Disaster Recovery funds.

Our objective was to determine whether TDHCA monitored its program management firm to ensure compliance with Federal and State regulations and to ensure costs reimbursed for the HAP and the SPRP were adequately supported.

RESULTS OF AUDIT

Finding: TDHCA Generally Ensured its Program Management Firm Complied With Requirements

TDHCA reviews and monitoring activities generally ensured that the Firm complied with Federal and State regulations and that program costs submitted for reimbursement were adequately supported. However, in a minor instance of noncompliance, TDHCA reimbursed the Firm \$71,691 for administrative costs that included a subcontractor's mark-up cost, which was based on a cost plus a percentage of cost payment type that is not allowed under CDBG rules. TDHCA had originally questioned the costs but subsequently allowed them because contractor staff provided support that made the expenditures seem plausible to TDHCA.

TDHCA's Monitoring Functions Were Independent and Organized

TDHCA had a well organized and independent Office of Oversight and Asset Division (Compliance Division) that ensured the CDBG Disaster Recovery programs were administered in compliance with contract provisions and Federal and State rules, regulations, policies, and related statutes. TDHCA also established and implemented adequate oversight and monitoring procedures to ensure program and financial compliance. Onsite monitoring visits were scheduled based on risk assessments. TDHCA's Compliance Division had the primary role of monitoring the Firm's contract to ensure compliance with State and Federal requirements. The Compliance Division was independent of the Disaster Recovery Division and had conducted four formal monitoring reviews of the Firm and the HAP and SPRP. In addition, the Internal Audit Division had conducted a formal independent audit of some aspects of the Firm's contract. Further, the Disaster Recovery Division staff maintained daily communication with the Firm and had also conducted various reviews and monitoring visits.

TDHCA Monitoring Activities Generally Ensured Compliance

TDHCA's monitoring goals were to provide reasonable assurance that the Firm complied with Federal, State, and CDBG program requirements. Since the inception of the contract, the Compliance Division, Internal Audit Division, and Disaster Recovery Division have conducted at least 20 monitoring reviews resulting in 11 monitoring reports or letters, which included at least 12 findings, 28 issues or problems, and 8 observations. TDHCA also monitored the corrective actions taken

by the Firm. In addition, TDHCA and the Firm established invoice and payment procedures that generally provided adequate assurance that payment draws were supported, properly authorized, approved, and accurately reported in the accounting systems.

Cost Submitted for Reimbursement Were Generally Supported

Eight separate draw downs totaling \$8.4 million, of the \$232 million allocated to the HAP and SPRP programs, were reviewed. About \$7.4 million of the draw downs consisted of administrative costs paid to the Firm. The review showed that the Firm's draw downs and TDHCA reimbursements were generally adequately supported; except for the payment of the ineligible mark-up costs of \$71,691² for "Admin Fees on Subcontractors."

In 2009, TDHCA's Compliance Division identified the "Admin Fees on Subcontractors" as unsupported. However, it later allowed the costs because they were included in the Firm's contract and budgeted as a subcontractor's costs.³ Yet, the subcontractor's explanation clearly showed that mark-up for "Admin Fees on Subcontractors" was calculated using a cost plus a percentage of cost method. Although State policy allows a cost plus a percentage of cost payment type method,⁴ HUD's State CDBG program regulations do not.⁵

Conclusion

TDHCA reviews and monitoring activities generally ensured that the Firm generally complied with Federal and State regulations and that program costs submitted for reimbursement were adequately supported. In most cases, TDHCA's reviews detected and corrected problems, except in the minor case of the ineligible mark-up.

² This amount represents less than .01% of the total draws reviewed ($\$71,691/\$8.4 \text{ million} = .009$)

³ Reznick, Mississippi, L.L.C.

⁴ Texas Contract Management Guide, chapter 3, Preparing the Solicitation, Payment Types

⁵ 24 CFR (Code of Federal Regulations) 570.489(g)

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Grant Programs require TDHCA to

- 1A. Recover from the Firm, \$71,629 for the "Admin Fees on Subcontractors" costs, and reimburse the appropriate HUD Disaster Recovery Program accounts.
- 1B. Continue to monitor and review program disbursements for ineligible cost plus a percentage of cost payment types.

SCOPE AND METHODOLOGY

We conducted our audit work at the TDHCA's office in Austin, TX, at its Firm's office, in San Antonio, TX, and the HUD OIG's office in San Antonio, TX. We performed our audit work between August and November 2010. The audit generally covered the period December 2007 through August 2010. To accomplish our objective we:

- Reviewed the Federal Register, CDBG, Disaster Recovery grant for hurricane recovery.
- Reviewed HUD's community development block grant regulations.
- Reviewed HUD's and TDHCA's Disaster Grant agreement.
- Reviewed TDHCA's and the Firm's policies, guides, and action plans for the Disaster Recovery program, monitoring process, and payment processing.
- Reviewed the contract between TDHCA and the Firm and other documents concerning monitoring, payment, and reimbursement processing.
- Reviewed TDHCA's monitoring reports.
- Interviewed TDHCA's and the Firm's managers and staff.
- Reviewed eight separate draw requests totaling \$8.4 million and verified supporting documentation from source documents provided by TDHCA and the Firm.
- Performed tests of the computer-processed data obtained from the TDHCA and the Firm. We determined the data to be sufficiently reliable to meet our objective.

To accomplish our objective, we reviewed the Firm's costs submitted for reimbursement to verify that costs were adequately supported and included in the contract budgets. We selected and reviewed eight separate draw downs totaling \$8.4 million of the \$232 million allocated to HAP and SPRP, of which \$7.4 million included draws paid to the Firm for administrative costs. A statistical sampling method was not used to select the draw downs; instead, the selection was based on the results of a risk assessment and prior audit findings. Thus, any results or conclusions stated in this report, only apply to the draws reviewed and cannot be projected to the entire \$232 million allocated to the programs. The draws, supporting documentation, and invoices are maintained by the Firm. According to TDHCA staff, a complete or effective review of the draw down documentation was not possible or practical when processing administrative draws for the Firm and construction draws for over 2,500 planned homes in a timely manner. TDHCA's main justification was that the draw down documentation was voluminous. TDHCA's Disaster Recovery Division required the Firm to keep the hardcopies of the draws and supporting invoices on-site and reviewed them on a test basis during monitoring visits or when necessary.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Monitoring review process
- Invoice and payment review process
- Proper execution and recording of transaction
- Appropriate documentation of transactions

We assessed the relevant controls identified above.

A deficiency in internal controls exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of the TDHCA's internal controls.

FOLLOW-UP ON PRIOR AUDITS

**The Texas Department of
Housing and Community
Affairs Did Not Fully Follow
Requirements or Best Practices
in the Acquisition of Its Disaster
Recovery-Funded Program
Management Firm,
2010-FW-1005**

We issued an audit report on the CDBG Supplemental II Disaster Recovery program funds in July 2010. The audit found that TDHCA did not follow requirements or best practices in the acquisition of its Disaster Recovery-funded program management firm. Specifically, it accepted and approved the only proposal received when the proposal's cost exceeded the request for proposals' specification by \$3.68 million. TDHCA made material changes to the contract that increased the maximum cost by \$1.99 million, budgeted \$210,000 in prohibited costs, and contracted to pay the Firm using multiple payment types including \$2.23 million for a cost plus a percentage of cost type, which is prohibited by Federal regulations. In addition, TDHCA's contract with the Firm lacked sufficient detail tying construction management services and oversight to the payment and budget section costs for the proper identification and allocation of \$14.33 million in costs. As a result, TDHCA could not ensure it received the best value to the State, and its contract included ineligible and unsupported costs of almost \$18.76 million. We recommended that HUD's Disaster Recovery Assistance and Special Issues Division Director require TDHCA to (1) adopt sound agency business procedures for Disaster Recovery-funded procurements in accordance with State policy, (2) train its staff members to ensure that they follow its policies, (3) reimburse its Disaster Recovery account for \$2.44 million in ineligible costs, (4) provide support for or reimburse \$16.32 million in unsupported costs, and (5) modify its contract language.

HUD agreed with all of the finding recommendations in the audit report. Based on the information provided by TDHCA, HUD indicated it would continue to work with TDHCA to ensure program compliance and to oversee the recommended actions for each finding. As of December 20, 2010, the recommendations are still in open status.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>
1A	\$71,691


1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments


TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
www.tdhca.state.tx.us

Rick Perry
GOVERNOR

Michael Gerber
EXECUTIVE DIRECTOR

BOARD MEMBERS
C. Kent Coninc, *Chair*
Gloria Ray, *Vice Chair*
Leslie Bingham Escareño
Tom H. Gann
Lowell A. Keig
Juan S. Muñoz, Ph.D.

January 19, 2011

Mr. Gerald Kirkland
U.S. Department of Housing and Urban Development
Office of the Inspector General
819 Taylor Street, Suite 13A09
Fort Worth, Texas 76102

Re: Letter of January 4, 2010 regarding Draft Audit Report 2011-FW-100X


Dear Mr. Kirkland:

The Texas Department of Housing and Community Affairs (TDHCA) appreciates the work performed on the audit of TDHCA's monitoring and oversight function of Community Development Block Grant (CDBG) Disaster Recovery funds. We take our responsibilities seriously and appreciate HUD's recognition of the controls in place to oversee these much needed disaster recovery funds. As you know, TDHCA has built these new programs from the ground up, and we are continuously striving for improvements. We greatly appreciate HUD's recognition of our efforts to ensure that taxpayer dollars are used in the most efficient and effective ways possible.

Management generally concurs with the report and is in the process of recovering \$71,691 from the Program Management Firm as identified in the report.

Again we appreciate the favorable report and thank you for your careful review. TDHCA looks forward to its continued relationship with HUD.

Sincerely,



Michael Gerber
Executive Director

MG:kc

221 EAST 11TH • P. O. BOX 13941 • AUSTIN, TEXAS 78711-3941 • (800) 525-0657 • (512) 475-3800
Printed on recycled paper

Comment 1

OIG Evaluation of Auditee Comments

Comment 1 TDHCA generally agreed with the audit report and is in the process of recovering the \$71,691 from the Firm. We acknowledge TDHCA's positive monitoring efforts and timely action in this matter.



Mayer Hoffman McCann P.C.

An Independent CPA Firm

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Leawood, Kansas 66211
913-234-1900 ph
913-234-1100 fx
www.mhm-pc.com

Received
AUG 25 2010
Compliance

August 20, 2010

Michael Gerber
Executive Director
Texas Department of Housing and Community Affairs
PO Box 13941
Austin, TX 78711

Dear Michael,

Mayer Hoffman McCann P.C. was selected by NeighborWorks America (NeighborWorks) to perform an agreed-upon procedures engagement to assist NeighborWorks in evaluating the compliance of over 275 organizations nationally with the requirements of their grant agreements under the National Foreclosure Mitigation Counseling (NFMC) Program. As you should be aware, NeighborWorks is accountable to Congress and ensuring that grantees are in compliance with the terms and conditions of the NFMC program grant is a high priority.

It should be noted that as a grantee, your agency is responsible for compliance with the terms and conditions of the NFMC grant award for itself and all of its sub-grantees. Therefore, all recommendations and findings found should be addressed by the grantee to ensure that the sub-grantee can become compliant.

Our testing consisted of a review of certain documents required to be maintained under the terms of the grant, a review of the completeness of client files and interviews of personnel involved with the NFMC program. We appreciate the assistance we received from your personnel in providing the documents requested and being available for our questions during the course of our engagement.

During this engagement, we noted the following items which we would like to bring to your attention.

FINDINGS NOTED:

Finding 1:

Section IV, Program Reporting Requirements D, Records Retention Policies, of the Round 2 Grant Agreement states the following:

"1. In accordance with applicable law, the grantee shall establish and comply with a records retention policy."

We noted that although your agency did have a records retention policy, it did not contain the required wording pursuant with Section IV, D, as follows:

"2. Financial records, supporting documentation, statistical records, and all records pertinent to the grant shall be retained for a period of three years from the date of submission of the final expenditure report. The only exceptions are the following:

- a) If any litigation, claim or audit is started before expiration of the 3 year period, the records shall be retained until the litigation, claims or audit findings involving the records have been resolved and final action taken.
- b) Records for real property and equipment acquired with the grant funds shall be retained for 3 years after final disposition."

RECOMMENDATIONS FOR RESOLVING FINDINGS:

Recommendation 1:

We recommend management revise its record retention policy to conform to the required wording per the grant agreement.

CONCERN NOTED:

Concern 1:

Though we noted that NFMCP was not tested as a major program we noted upon the review of your August 30, 2009 audit, the following findings:

117 Findings related to major programs in testing related to OMB Circ A-133. We noted that there is a concern that some of the issues discovered in this audit might be similar to or cause issues in the future with the NFMCP funding.

Concern 2:

NeighborWorks America instituted a new procedure during the Round 2/Round 3 on-site and remote compliance review period. The results of our review allow us to raise the awareness to NFMC grantees about the importance of proper and effective segregation and tracking of both NFMC funds and the related match.

It is important that grantees track the source and expenditure of Match funds to ensure it is being used in accordance with the NFMC grant agreement. We encourage grantees to ensure that there is adequate segregation of NFMC and Match funds within their foreclosure counseling program.

When tracking in-kind match, grantees should maintain detailed supporting records for all components of the in-kind match calculation provided to NeighborWorks America. For example, supporting records for staff time used to meet the Match requirement should include the dates and number of hours of service along with the payroll records to support the pay rate used in the Match calculation.

General ledger tracking is an essential practice for effective financial records. NeighborWorks America encourages grantees to have in place separate general ledger accounts for NFMC funds awarded, the Match funds being applied to the program as well as for tracking the related NFMC expenditures.

We noted that your organization did not provide sufficient general ledger detail as requested to support that these funds were being used for the Grantee's foreclosure program.

RECOMMENDATIONS FOR RESOLVING CONCERN:

Recommendation 1:

We recommend the agency put policies or procedures in place to resolve the findings in the current year, and mitigate the number and type of findings in the future years.

Recommendation 2:

We recommend management put policies and procedures in place to effectively segregate and track all aspects of the match requirement.

CONCLUSION:

Management at NeighborWorks is acutely aware of each grantee's sensitivity to any areas of non-compliance that may be included in our final report. NeighborWorks has requested that any areas of non-compliance be reported to the grantee and that an opportunity for response be allowed. As such, please provide us a written response to the above findings within 15 days of the receipt of this letter. We assure you that your response will be incorporated into the final report to be issued to NeighborWorks. If no response is received within 15 days, we will note as such in our report.

_____ We acknowledge the receipt of this letter and that no findings were identified above. We understand that this does not preclude NeighborWorks from future reviews.

_____ We acknowledge the receipt of this letter and have no response to the findings noted above. We understand that this does not preclude NeighborWorks from future reviews.

_____ We acknowledge the receipt of this letter. Please see our response attached. We understand that this does not preclude NeighborWorks from future reviews.

Signature: _____

Name Printed: _____

Title: _____

Date: _____

**Texas Department of Housing and Community Affairs response
to the National Foreclosure Mitigation Counseling grant funds
audit by Mayer Hoffman McCann P.C.**

This document is in response to the letter received on August 25, 2010 from Mayer Hoffman McCann which delineated one audit finding and two concerns for the Texas Department of Housing and Community Affairs (TDHCA) National Foreclosure Mitigation Counseling (NFMC) funds received as a result of successful grant applications from NeighborWorks America.

Response to Finding 1

Finding 1 addressed the record retention policy for NFMC. While Mayer Hoffman McCann noted that TDHCA does have a records retention policy, the policy did not contain the required wording pursuant with Section IV, D, as listed in the letter. TDHCA has taken Mayer Hoffman McCann's recommendation and revised its record retention policy to conform to the required wording per the grant agreement.

TDHCA submitted a Records Retention Schedule Certification Amendment (SLR 122) form to the Texas State Library and Archives Commission on September 1, 2010. The form was signed by David Cervantes, Director of Financial Administration, who oversees records retention. NFMC was assigned a records series item number. The code "AC+3" on the amendment form signifies that the records will be kept for three years after the closing of the contract. A copy of this form is included with this response.

Once the form is accepted by the Texas State Library and Archives Commission, the form can be customized to include the following language under "Remarks" (Section 9):

"Financial Records, supporting documentation, statistical records, and all records pertinent to the grant shall be retained for a period of three years from the date of submission of the final expenditure report. The only exceptions are the following:

- a. If any litigation, claim or audit is started before expiration of the 3 year period, the records shall be retained until the litigation, claims or audit findings involving the records have been resolved and final action taken.*
- b. Records for real property and equipment acquired with the grant funds shall be retained for 3 years after final disposition."*

The Housing Resource Center at TDHCA is the responsible party for the NFMC records. The Housing Resource Center jointly oversees the NFMC program with the Texas Homeownership Division at TDHCA and works closely with the Texas State Affordable Housing Corporation, the state's administrator for these funds. The Housing Resource Center will keep the NFMC records in a locked file cabinet in the TDHCA Headquarters at 221 E. 11th Street, Austin, TX, 78701. Three years after the close of the contract, the hard copies can be destroyed, although electronic copies are kept permanently.

Response to Concern 1

Concern 1 addressed the State's audit. The 117 findings related to major programs in testing related to OMB Circ A-133 have to do with the *Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2009* (Report). While the Report includes TDHCA's financials, it does not only pertain to TDHCA. Of the 117 findings, only 3 pertain to TDHCA programs and 0 pertain to TDHCA's NFMC program. The other 114 findings have to do with other Texas state agencies.

**Texas Department of Housing and Community Affairs response
to the National Foreclosure Mitigation Counseling grant funds
audit by Mayer Hoffman McCann P.C.**

The 3 findings for TDHCA are currently being addressed, as shown on pages 216 to 221 of the Report. Therefore, Mayer Hoffman McCann's recommendation that policies and procedures be put in place to resolve the findings in the current year and mitigate the number and type of findings in the future has been taken.

Response to Concern 2

Concern 2 addressed the general ledger accounting for NFMC funding and expenditures. TDHCA's NFMC program only uses cash match; no in-kind match is used. The NFMC funds and NFMC match funds are kept in their own bank account separate from other sources of funds in order to segregate and track all aspects of the match requirements. The bank account for NFMC funds is kept by the Texas State Affordable Housing Corporation (Corporation), which entered into a Memorandum of Understanding (MOU) to administer the program in return for NFMC administrative and program-related support funds from TDHCA. The bank account is at Frost Bank.

The Corporation's accounting system properly segregates and tracks all NFMC funding, the related NFMC match and NFMC expenditures. The NFMC Program accounting system consists of separate general ledger accounts for NFMC grant awards received, NFMC match funds received, NFMC expenditures, NFMC cash (which is maintained in a separate bank account) as well as corresponding general ledger accounts for receivables and payables. Additionally the Corporation maintains subsidiary ledgers for all funding and expenditures broken down by grant award category for Counseling, Operational Oversight and Program Related Support. Subsidiary accounts are also maintained for each HUD-Approved Counseling Agency comparing each entity's approved budget to actual expenditures. All subsidiary accounts are reconciled to each other as appropriate and to the general ledger on a monthly basis. Copies of the general ledger income and expenditure accounts are included with this response. We have also included copies of the detailed subsidiary funding and expenditure reports separated by Round 2 and Round 3 as well as the subsidiary reconciliation by grant award category. If you have any questions please give Melinda Smith, Chief Financial Officer at the Corporation, a call at 512-423-2412.



March 11, 2011

Michael Gerber
Executive Director
Texas Department of Housing and Community Affairs (TDHCA)
PO Box 13941
Austin, TX 78711

Very good.
Eric / Elizabeth
Tom
- MB

Dear Michael:

NeighborWorks® America would like to thank you for your response to its Quality Control and Compliance Review conducted by Mayer, Hoffman and McCann on behalf of the National Foreclosure Mitigation Counseling (NFMC) Program. As a recipient of NFMC funding, your organization as well as sub-grantees, branches, and/or affiliate offices are subject to site visits, file audits, and other measures to ensure program compliance performed by NeighborWorks® America and its authorized representatives.

Mayer, Hoffman and McCann, P.C. conducted an onsite or remote review of your organization based on NFMC Program guidelines stated in the respective funding announcements, grant agreements, and subsequent program announcements. MHM sent a confirmation letter notifying your organization of findings noted during the review and recommendations for resolving the findings. Your organization was required to respond to the noted findings with documented evidence demonstrating compliance with NFMC Program guidelines as well as recommendations provided by Mayer Hoffman McCann. NFMC staff has reviewed your response to the noted findings and find the following:

_____ Your agency did not have any findings or recommendations.
No further action is required.

 X Your findings have been cured based on the documented evidence provided in your response.

_____ Your findings have not been cured. Please provide the following documented evidence to cure your findings:

Finding 1: CURED

TDHCA provided documented evidence to cure the finding. A summary of the finding is below.

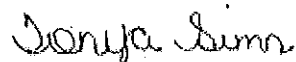
Section IV. Program Reporting Requirements D. Records Retention Policies of the Round 2 Grant Agreement:

At the time of review, it was noted that your agency did have a records retention policy, but it did not contain the required wording pursuant with Section IV, D.

Thank you for responding to the noted concerns. We will let you know if we need any additional documentation.

Thank you for your time and consideration.

Sincerely,



Tonya Sims
Senior Program Manager, National Foreclosure Mitigation Counseling Program

NSP NEEDS ASSESSMENT REPORT

FIRM: TDA – TRAINING AND DEVELOPMENT ASSOCIATES

DATE: February 15, 2011

RECIPIENT: STATE OF TEXAS

RECIPIENT NSP GRANT NUMBER: B-08-DN-48-0001

NEEDS ASSESSMENT WORK PLAN NUMBER:TDA077

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EXECUTIVE SUMMARY

Summary

In January 2011 Training and Development Associates, Inc. (TDA, Inc.) assessed the State of Texas Neighborhood Stabilization Program (NSP1) plan and implementation to date. The three-person assessment team interviewed twelve people from the lead entity, the Texas Department of Housing and Community Affairs (TDHCA). We also met with their partner, the Texas Department of Rural Affairs (TDRA), and conducted site visits with six of their subrecipients. Additionally, assessment team members reviewed 30 documents. A summary of the State of Texas NSP program is followed by a list of key observations and recommendations for future technical assistance.

State of Texas NSP Program

The State of Texas was allocated just over \$101 million in NSP1 funding. The state assigned TDHCA as the lead entity for the program, and they provide all of the grant administration and reporting to HUD. However, \$19 million of the allocation was provided directly to TDRA to subgrant under its own program focused on rural areas of the state. An additional \$6 million has been provided to Texas State Affordable Housing Corporation (TASHC) specifically for the purpose of state-wide land banking activities. The remaining approximately \$75 million has been subgranted to organizations across the state by TDHCA for all five eligible activities. All activities are being treated as loans by the state, requiring closings at each step of the process. This was done in an effort to ensure sound underwriting practices and from their perspective, avoid the mistakes of the past.

Over the last year, it appears that TDHCA has significantly increased its capacity to oversee and effectively administer the NSP1 program. They have provided a number of program specific trainings to their subrecipients, as well as training on overlay requirements such as procurement. There remain substantial challenges to the ultimate success of the program, and key findings and recommendations are outlined below.

Key Findings

- The state is currently fully obligated. However, many of these obligations are at risk due to pipeline issues.
- There appears to be a serious bottleneck in their current design, which is substantially impeding progress. With each unit potentially requiring multiple closings (acquisition, rehab and resale may in some cases all be discrete closings), there is one paralegal and one attorney assigned to NSP. There are currently units in the pipeline from last fall that have not closed as a result.
- In an effort to fully obligate, some subrecipients were provided a last minute opportunity to expand their program. In one instance an award increased from \$2 million to potentially \$8 million overnight, with no increase in the organization's capacity.
- The state has a requirement of subrecipients that they be 70% expended by the end of February, and anticipate that most will fall short of the mark. As of 1/25/2011, 6 out of 37 TDHCA subrecipients were more than 50% expended.

Key Recommendations

- In the opinion of the assessment team, the State of Texas Department of Housing and Community Affairs (TDHCA), its partner TDRA and their combined subrecipients require immediate on-site assistance to successfully move the state's program forward. While the state has obligated 100% of its funds, nearly \$12 million of the \$19 million under TDRA is at significant risk, and a significant amount of the deals obligated by TDHCA and TDRA will fall out due to the legal "funnel". They need assistance in saving the deals that are salvageable, increasing the capacity of their internal structure and helping their subrecipients replace deals that have been lost due to timing. Without significant assistance, the state is at risk of having a significant portion of its funds not properly expended by the deadline, and of having potential compliance issues with those that are.

- It is recommended that in order to address this baseline need a team be provided to provide the following assistance:
 - Two days of week for a NSP resource person/lead consultant focused on activity level concerns, program/policy design and compliance with the state staff.
 - Three days a week for a Project Management person focused on the multifamily projects and the construction management needs related to the subrecipients.
 - Five days a week for a Circuit rider (this could be a shared duty) to provide assistance to the TDHCA and TDRA subrecipients of the state.

- In addition to the ongoing assistance to be provided by the team above, a considerable amount of training will be necessary for state staff and subgrantees.

- The entire scope of work represents 211 days of technical assistance, or approximately 3.5 FTE for the 3 month period. This is exclusive of team coordination, travel, and prep time.

NSP NEEDS ASSESSMENT REPORT

TO: Sylvia Purvis, HUD Office of Technical Assistance

FROM: Dionne Roberts, NSP Manager

FIRM: TDA – TRAINING & DEVELOPMENT ASSOCIATES

DATE: FEBRUARY 15, 2011

RECIPIENT: STATE OF TEXAS

RECIPIENT NSP GRANT NUMBER: B-08-DN-48-0001 (NSP1)

NEEDS ASSESSMENT WORK PLAN NUMBER: TDA077

1. NEEDS ASSESSMENT DATE

12/22/2010 – 01/31/2011

2. DOCUMENT(S) REVIEWED

1. Grantee Self-Assessment
2. DRGR quarterly report ending March 31, 2010
3. NSP1 Substantial Amendment
4. NSP1 Substantial Amendment Modification dated February 25, 2010
5. NSP1 Notice of Funding Availability
6. NSP Reallocation Notice of Funding Availability
7. NSP Program Income Notice of Funding Availability
8. NSP3 Substantial Amendment
9. TDHCA NSP Technical Guide
10. Texas NSP Homebuyer Financing Underwriting Guidelines

11. Policy Map Data (TDA generated)
12. TDHCA NSP Program Implementation Workshop powerpoint
13. TDHCA NSP Procurement Workshop powerpoint
14. TDHCA NSP Homebuyer Program Workshop powerpoint
15. TDHCA NSP Construction and Rehab Draws Workshop powerpoint
16. Texas NSP Local Community Contacts (sorted by County)
17. TDHCA NSP Status Report dated 1/25/2011
18. TDRA NSP Status Report of January 26 th , 2011
19. City of El Paso Contract File
20. Tarrant County Housing Partnership Properties List
21. Tarrant County Housing Partnership NSP Homebuyer's Assistance Guidelines
22. Scope of Services Proposal for Environmental Clearance Review for subrecipient (Texoma)
23. Work Write Up/Cost Estimate for 715 E. 5 th , Bonham, TX (Texoma)
24. Work Write Up/Cost Estimate for 1124 E. Epstein St, Sherman, TX (Texoma)
25. List of Texoma awards provided by TDRA (original and amended amounts)
26. TDHCA NSP Monitoring Letter to Frazier Revitalization, Inc.
27. TDHCA Monitoring Report (draft) of the City of Houston, dated February 2 nd , 2011
28. TDHCA Monitoring Report of Texas State Affordable Housing Corporation dated December 30 th , 2010

29. El Paso Housing Finance Corporation Loan Closing File - 1737 Dave Elliott Drive

30. Texas State Affordable Housing Corporation (TASHC) map of NSP Land Bank development partners and localities

3. INTERVIEWS CONDUCTED

<i>Full Name</i>	<i>Position</i>	<i>Responsibilities/Role</i>	<i>Date (MM/DD/YYYY)</i>
Timothy Irvine	Chief of Staff and General Counsel, TDHCA	Executive team at TDHCA	1/25/2011
Tom Gouris	Deputy Executive Director for Housing Programs, TDHCA	Oversees division that includes NSP	1/25/2011
Marni Holloway	NSP Manager, TDHCA	Provides day to day management of NSP Program	1/25/2011
Tom Kincaid	NSP Rep, TDHCA	Works directly with subrecipients	1/25/2011
Dewell Fears	NSP Program Specialist, TDHCA	Works directly with subrecipients	1/25/2011
Megan Sylvester	NSP Rep, TDHCA	Works directly on multifamily deals	1/25/2011
Marie Esparza	NSP Program Specialist, TDHCA	Works directly with subrecipients	1/25/2011
Cris Simpkins	TDHCA	Serves as resource to NSP program	1/25/2011
Kelly McKinney	TDHCA	Serves as resource to NSP program	1/25/2011
Joniel Crim	Contract Specialist, TDHCA	NSP closings	1/25/2011
Sue Cavazas	Contract Specialist, TDHCA	NSP closings	1/25/2011

Mark Wyatt	CDBG Division Director, TDRA	Oversees division that includes NSP	1/25/2011, 1/26/2011 and 1/27/2011
Alexandra Gamble	NSP Manager/Program Development Specialist, TDRA	Provides for day to day management of NSP program	1/25/2011, 1/26/2011 and 1/27/2011
Lucy Trevino	Manager, Contract Monitoring, TDHCA	Provides monitoring for all of TDHCA's programs, including NSP	1/26/2011
Dawn Elder	Program Development Specialist, TDRA	Works directly with subrecipients	1/26/2011
David Danenfelzer	Manager, Texas State Affordable Housing Corporation (TSAHC)	Oversees NSP project for TSAHC	
Donna VanNess	President, Tarrant County Housing Partnership	Provides executive leaderships	1/27/2011
Julie Hostak	Grants Compliance Manager, Tarrant County Housing Partnership	Runs NSP program day to day	1/27/2011
Guy Burgoon	President, Emerging Markets Group	Runs NSP program for Texoma HFC	1/27/2011
Kevin Farley	City Manager, City of Pottsboro	Texoma HFC Board member	1/27/2011
Rod Radel	Director, San Antonio Alternative Housing Corp.	Oversees and runs day to day operations	1/28/2011
Jon Edmonds	President and CEO, Frazier Revitalization Inc.	Oversees agency including NSP effort	1/28/2011
Hank Lawson	Community Engagement, Frazier Revitalization Inc.	Provides outreach and on the ground work for NSP program	1/28/2011
Lois Edmonds	Executive Assistant, Frazier Revitalization Inc.	Provides administrative support for NSP	1/28/2011

Mike Mason	City of Port Arthur, TX	Oversees NSP program	1/28/2011
Shawna Williams	City of Port Arthur	Works in NSP day to day	1/28/2011
Beverly Freeman	City of Port Arthur	Works in NSP day to day	1/28/2011

4. MARKET OBSERVATIONS

The state of Texas has had an uneven experience during the housing downturn, reflecting the broad economic diversity of the state. During 2010, the state hits its lowest point, with the state seeing a 35% increase of foreclosures in February- the highest monthly gain of any state in the country¹. The Federal Reserve reported that in the 3rd quarter of 2010, 90+ delinquencies were up 5.3% nationally. The state of Texas was significantly below this in some areas and more than double the national rate in others:

90+ delinquencies:

Travis County - +2.7
LaSalle County - +11.5
Harris County - +4.8

As a result of this unevenness, there are a variety of approaches being taken across the state, which are discussed further on in this review.

While delinquencies varied, the overall sales market was more stable than many nationally. In 2010, Texas homes sales dropped 5% compared to 2009, with a median price increase of 1%². The amount of inventory on the Texas market at the end of the fourth quarter was 7.5 months, according the TAR. The firm and its university research counterpart consider inventory anywhere in the range of 5.5 to 7.5 months a balance of supply and demand in the market.

Forecasters have predicted continuing declines in value in 2011, with some outliers such as Austin and El Paso predicted to see small gains.

Housing Devaluation Predicted for 2011³

City	Forecast
Houston	- 4.1%
Dallas	- 3.4%
Austin	2.8%
San Antonio	- 3.9%
Lubbock	- 2.4%

¹ Data from ForeclosureListings.com

² Texas Association of Realtors

³ Housingpredictor.com

Amarillo	- 2.2%
El Paso	2.8%

A summary of this diversity and some of the market variations behind it is below:

- A rising supply of foreclosed homes hitting the market coupled with short sales is also taking their toll as the **Dallas-Forth Worth** area experienced record foreclosures. A back-log of inventory and more mortgage holders walking away from homes in the New Year will have an enormous impact on the market even with comparatively high employment levels.
- In **Houston** home sales plunged after the tax credit was cancelled. Double-digit declines in home sales took their toll on the market, which has historically been one of the lower priced urban markets in the country. Sales are showing weakness, which means prices should continue to move southward. However, a lower inventory of homes listed for sale than in many other regions should aid Houston and send it on its way into a housing recovery.
- In **San Antonio** the real estate downturn hasn't been felt as much as many other areas. Home sales were nearly identical in terms of volume in San Anton for two straight years as prices declined modestly.
- In **Amarillo** it's still a buyer's market controlling the local conceptions of the public. An over-supply of properties listed for sale will keep things slow for a while longer, despite near record low mortgage rates. The inventory of homes is bulging in Amarillo and until troubled properties including foreclosures can be cleared from the market prices will move southward.
- It was the same story in **Abilene** as most other markets after the federal tax credit – slower home sales. But a natural gas boom has added more jobs for the area and that should prove to be beneficial for the local economy. Any sort of a boom in real estate, however, is unlikely as Abilene moves back into the sort of slow-paced market that it has been for years.
- Down the panhandle in **Lubbock**, home sales showed a small gain for a time after the federal credit expired, but when you're talking dozens of sales a month it hardly matters.
- **El Paso**, on the U.S.-Mexico border of Juarez, is experiencing better economic times as a result of the 2005 ordered military Base Closure and Realignment Commission act. Congress couldn't have any idea of it at the time, but El Paso is actually benefitting from the act as Fort Bliss undergoes a major building boom to become one of America's largest military installations. The boom has produced an economic bellwether for a community that would otherwise be in economic peril.

These variations reinforce the importance of understanding markets at the local level . With rare exceptions, there is a broad lack of understanding of the local marketplace by local communities. The market is seen as a static place, where large volumes of foreclosures should translate into high numbers of units available. The concept of a band of affordability, governed by target areas, community or neighborhood conditions, house price, buyer credit scores and buyer cash seems to be widely lost on NSP sub-recipients engaged in shared equity loans and First Time Homebuyer programs.

5. NSP PROGRAM REQUIREMENTS AND RULES

Numeric Rating: 3 out of 5

Grantee's capacity:

TDHCA's NSP program is managed by Marni Holloway, who joined TDHCA in May of 2009. She is supported by the previous NSP Manager, who is now the Deputy Director over NSP, as well as by a staff that includes four reps and at least two contract specialists. Marni is the only NSP staff person with a housing background, and she has one staff person with a compliance background. While the staff generally understands NSP, and have increased their capacity significantly over the last year, they acknowledge that it has been a steep learning curve. As a result, there are still significant knowledge gaps related to both housing programs in general and NSP in particular.

One result of this is that subrecipients indicated a high level of dissatisfaction with their TDHCA representatives. The dissatisfaction appears to be directly related apparent inconsistencies and changes in course or direction by TDHCA.

TDRA's NSP program is managed by Alex Gamble. She is supported by Mark Wyatt, who is the division director over CDBG, and therefore NSP, for TDRA. CDBG funds from TDRA have generally not been provided for housing related activities in the past, and as a result the staff is at a disadvantage in understanding both housing programs in general and NSP in particular. These gaps were highlighted in conversations around inspection and monitoring requirements. TDRA recognizes the challenge they face, and has requested intensive TA to assist them in moving their projects forward in a compliant manner.

Subrecipient/developer/nonprofit capacity:

TDHCA provided its subrecipients flexibility in utilizing all five eligible activities under NSP, and this is reflected in the range of activities being undertaken. In keeping with the housing preferences in Texas as a state with substantial undeveloped areas, many subrecipients are opting for new construction as opposed to rehab of existing units. Reviews of subrecipient progress and on site visits revealed a significant lack of understanding of program fundamentals, both process and project related.

TDRA has also provided flexibility, and has experience similar capacity issues with some of their subrecipients. There have been both process and project related misunderstandings. TDRA has one subrecipient with seven (7) unexecuted contract amendments, totaling 25% of TDRA's allocation. Initial issues around the authorized signatory have expanded to a desire to make changes other than the amounts and the period of performance.

This combination of project related capacity as well as grant administration challenges has the potential for a significant negative impact on the state's program.

Recommended TA actions and work products:

- Training should be offered on homebuyer qualification and underwriting
- A Project Management consultant should be provided to assist with multifamily projects at both the state and subrecipient level
- TA and training should be provided on NSP to TDHCA and TDRA staff in areas of tenant rights, eligible costs, eligible uses, income documentation, other NSP rules and the HOME overlay as requested by grantee

6. PROGRAM DESIGN

Numeric Rating: 2.5 out of 5

Grantee's capacity:

The State allowed its subrecipients to access all five eligible activities, and has done a number of contract amendments in an attempt to be flexible. They have identified differences in approaches based on demographics. For example, most of the valley programs are single family, and nearly all multi-family is taking place in urban centers such as Dallas/Ft. Worth, Austin, San Antonio and Houston. As state staff has been learning the program, they have become most comfortable with the more common program designs.

The state has designed its program so that all funding comes to subrecipients as loans. This is based on an early decision by TDHCA to enforce sound underwriting practices. In addition, the state also plans to underwrite all homebuyer activities, and is currently finalizing its underwriting criteria for this purpose. The state acknowledges that this approach will require all of its NSP team to become efficient homebuyer underwriters, given that this approach will result in them having to underwrite literally hundreds, if not thousands, of homebuyer purchases. Staff currently does not have this capacity.

Subrecipient/developer/nonprofit capacity:

Reviews of subrecipient progress and on site visits revealed a variety of program designs and capacity. There was a significant amount of landbanking activity being undertaken in addition to the activity of the TSAHC program. Much of this is being done by organizations with no experience in landbanking.

There is also substantial new construction activity, again reflective of the large amount of undeveloped land in the state. One TDRA subrecipient who has no construction background plans to construct 72 new single family homes over the next ten months, although no lots have currently been acquired.

Recommended TA actions and work products:

- Training and TA on marketing and affirmative marketing for subrecipients
- TA and training to TDHCA and TDRA staff on the real estate development process, single family underwriting, and asset/land bank management
- Land bank management training to subrecipients

7. PROGRAM ADMINISTRATION & GRANT MANAGEMENT

Numeric Rating For Administration: 2 out of 5

Numeric Rating For Grant Management: 2 out of 5

Grantee's capacity:

TDHCA and TDRA have worked to expand their capacity to manage the NSP program, and have modified existing processes for this purpose. TDHCA has an electronic contract administration system through which they provide information to subrecipients and subrecipients submit documentation for review by the state. This system is a good approach given the geographic challenges and is more environmentally friendly than a 100% paper system.

There are three primary capacity challenges within grant management and administration that we identified during the assessment. First, staff is in some instances overwhelmed by a grants management process they do not fully understand. In one instance, a staff person acknowledged that when a subrecipient does not provide information, the staff person fills out the form "for them". While perhaps addressing the immediate issue, this approach is not sustainable.

The second challenge is the lack of staffing for DRGR. The NSP Program Manager is currently also responsible for all entry into DRGR, with finance doing the draws. The state is currently three quarters behind in their reporting as a result, with the most recent approved QPR period ending March 31, 2010. The entry will only increase once the final challenge is addressed, and additional staff capacity is necessary in this area.

The most critical capacity issue relates to the early decision to structure all activities as loans to the subrecipients, therefore requiring multiple closings per unit. This has led to the legal process within TDHCA becoming a bottleneck for the entire NSP program. There is one (1) FTE legal and a paralegal to handle approximately 1,200 closings in the short term and an estimated additional 1,500 to 2,000 closings over the compliance period. The first batch of closings consists of:

1. Seven (7) multifamily properties
2. Seven hundred thirty (730) land bank properties
 - a. As these properties are distributed to developers an additional seven hundred thirty (730) closings will be needed
 - b. As these properties are completed and sold to homebuyers an additional seven hundred thirty (730) closings will be needed
3. Four hundred ten (410) purchase/rehab properties and new construction single family homes
4. Five hundred twenty (520) additional homebuyer assistance closings will be needed.

It is the opinion of the assessment team that this issue virtually obscures all other existing challenges. If this issue is left unaddressed, it will not be possible for the state to have any chance of successfully expending their funds, and assistance around other issues would be unproductive.

TDRA manages \$19 million of TDHC's NSP1 allocation directed at rural locations through the state. TDRA awarded twenty-five (25) sub-recipients prior to obligation, of which 18 are still involved. TDRA is accustomed to managing CDBG infrastructure projects in the non-entitlement areas of Texas. The NSP1 program contains significant elements at the grants management level which TDRA has not completely absorbed. Among those elements are the need for multiple levels of monitoring in housing programs which involve sale to specific beneficiaries. Although TDRA stated they would rely on TDHCA's monitoring manuals and expertise, by Memo of Understanding ("MOU") TDRA is responsible for monitoring TDRA's projects. TDRA also identified a challenge in identifying specific benchmarks. For example, there is no standard for the amount of time a sub-recipient should take to reach a specific expenditure benchmark.

Subrecipient/developer/nonprofit capacity:

At this time, the primary challenge of the subrecipients relate to their inability to get deals through the pipeline on the state side. That said, there are also some needs around the electronic contracts system and the overall process. During on site visits a checklist of what they need for each step in the process was requested, as was training in the contracts system. One visit ended up including providing assistance with filling out the agency's first draw request form

Recommended TA actions and work products:

- The key need is for TDHCA to unclog or resolve the legal bottleneck. The scope of what TDHCA legal needs to review should be limited to a few documents based on models for each program type. The state should also considering accessing outside contractors if additional internal capacity is not a possibility.
- Training on grants management to state staff, with a focus on housing projects
- Training for new DRGR staffing

8. PROJECT FINANCING

Numeric Rating: 2 out of 5

Grantee's capacity:

At TDHCA, only the NSP Manager has housing experience. One additional staff person has been using their compliance background as a foundation for assessing multifamily projects, but there is no training or education that has been received in the area of financing.

Given the intent of TDHCA to have all staff be able to underwrite homebuyer activities, this capacity gap will become more critical further down the road.

At TDRA, there are no staff with financing experience for the projects that they are working on. To a large degree, both agencies are relying on their subrecipients to bring this capacity to the table. While in some cases this is possible, it leaves the state staff at risk of not being able to identify key issues that a subrecipient may not recognize, or may prefer not to acknowledge.

Subrecipient/developer/nonprofit capacity:

Reviews of subrecipient progress and on site visits revealed an uneven level of capacity. There are a number of subrecipients that have experience and capacity to develop sustainable deals. There are also a small number of subrecipients that have capacity challenges in this regard, often because they have used NSP to step outside of their normal activities. As a result, the usefulness of their prior experience is uneven.

Recommended TA actions and work products:

- Provide staff training for single-family underwriting
- Identify a Project Management consultant to assist with multifamily projects at both the state and subrecipient level.
- Provide TA and training to TDHCA and TDRA staff on the real estate development process, single family underwriting, and asset/land bank management

9. FINANCIAL MANAGEMENT

Numeric Rating: 3.5 out of 5

Grantee's capacity:

The finance department is accustomed to dealing with federal funds and is using their existing systems for this purpose. The primary challenge relates to DRGR. As noted previously, lack of staffing has put the state substantial behind in its reporting. This will need to be addressed so as not to impact the financial management of the program, especially as program income begins to be reported and returned to the state.

Subrecipient/developer/nonprofit capacity:

Reviews of subrecipient progress and on site visits revealed an uneven understanding of the financial management requirements of NSP. Generally, those with previous experience with federal funds were better situated to understand and meet the requirements.

Recommended TA actions and work products:

- Training on Uniform Administrative Requirements (A-87, A-133, Part 85) for state staff and subrecipients
- TA as needed on DRGR

10. OTHER FEDERAL REQUIREMENTS

Numeric Rating: 2.5 out of 5

Grantee's capacity:

TDHCA has done some training on overlay requirements for its staff, most of whom have limited previous experience. These requirements also need to be presented in the context of additional state requirements. For example, the TDHCA Board has passed a resolution declaring that ALL federal dollars in the agency are to comply with Section 3.

TDRA staff has some understanding of the overlay, especially in those areas that they have dealt with in CDBG infrastructure projects, such as Davis-Bacon. Other requirements, such as relocation, they have had limited or no experience with previously.

While both agencies have made efforts to provide information to their staff, their ability to oversee projects and assist their subrecipients would be greatly enhanced by training.

Recommended TA actions and work products:

Provide staff and partner training opportunities for:

- Davis Bacon/Labor Standards
- Environmental Review
- Fair Housing and Equal Opportunity (inc. Section 504 and Section 3)
- Provide training on cross-cutting requirements to subrecipients, including Section 3; Environmental; 504/ADA; Affirmative Marketing; UAR; and procurement

11. CONSTRUCTION

Numeric Rating: 2 out of 5

Grantee's capacity:

Other than Marni, TDHCA and TDRA do not have any staff with a construction background. As a result, they are at times at a loss as to what the next step should be, or the correct question to ask. They are in many instances counting on their subrecipients to know the process and proceed correctly. This has already led to some misunderstandings, such as state staff advising subrecipients that an HQS inspection would be sufficient for a rehab project. As projects continue to move forward, additional training in this area will build on the staff's knowledge.

Subrecipient/developer/nonprofit capacity:

While a number of subrecipients have sufficient capacity for the activities that they have undertaken, there are a significant number that have little or no capacity in the activities they are attempting to carry out. In these instances, the reliance of state staff on subrecipients to know the rules has trickled down to subrecipients relying on developers and consultants.

In one instance, this resulted in no one at the subrecipient or state level having a concern over a proposal to build new, IBC code compliant, energy efficient, three bedroom, 1,000 square foot single family homes at \$64 a square foot. When common questions were raised by the assessment team on this project, both the subrecipient and state staff stated that they had seen no obvious problems, as the form was fully completed.

Recommended TA actions and work products:

- Identify a Project Management consultant to assist with multifamily projects at both the state and subrecipient level.
- Provide TA and training to staff in construction project management
- Provide TA and training on both initial inspections and closing inspections

12. COLLABORATION

Is the grantee experiencing substantial issues in creating partnerships or working with lenders or developers? If yes, what are the issues?

The grantee has not created partnerships, and is expecting its subrecipients to do so on an as needed basis. Subrecipients are responding accordingly. Unfortunately, many have not followed procurement requirements in creating these partnerships with developers and are now having to re-procure for services.

13. SUMMARY OF RECOMMENDED SCOPE OF WORK

In the opinion of the assessment team, the State of Texas Department of Housing and Community Affairs (TDHCA), its partner TDRA and their combined subrecipients requires immediate on-site assistance to successfully move their program forward. While the state has obligated 100% of its funds, nearly \$12 million of the \$19 million under TDRA is at significant risk, and a significant amount of the deals obligated by TDHCA and TDRA will fall out due to the legal "funnel". They

need assistance in saving the deals that are salvageable, increasing the capacity of their internal structure and helping their subrecipients replace deals that have been lost due to timing. Without significant assistance, the state is at risk of having a significant portion of its funds not properly expended by the deadline, and of having potential compliance issues with those that are.

It is recommended that in order to address this baseline need a team be provided to provide the following assistance:

- Two days of week for a NSP resource person/lead consultant focused on activity level concerns, program/policy design and compliance with the state staff
- Three days a week for a Project Management person focused on the multifamily projects and the construction management needs related to the subrecipients
- Five days a week for a Circuit rider (this could be a shared duty) to provide assistance to the TDHCA and TDRA subrecipients of the state.

In addition to the ongoing assistance to be provided by the team above, a considerable amount of training will be necessary for state staff and subrecipients. Some of the needs below will be met by the team, and others will require accessing specific resources outside of the team. The team will need to make a determination soon after arrival whether this training could be remote (web-based), off-site or on-site as well as work with HUD to try to maximize efficiency of efforts.

1. Identify a lead TA consultant/NSP resource person to lead the on-site effort who can be available a minimum of two days a week for at least three months. *40 days*
2. Identify a Project Management consultant to assist with multifamily projects at both the state and subrecipient level. They will need to be available at least 3 days a week the first month, 2 days a week for the following two months. *48 days*
3. Identify at least one circuit rider to begin providing assistance directly to subgrantees at the direction of the lead consultant. *60 days*
4. Provide TA and training on NSP to TDHCA and TDRA staff in areas of tenant rights, eligible costs, eligible uses, income documentation, other NSP rules and the HOME overlay as requested by grantee *20 days*
5. Provide TA and training to staff in construction project management. *3 days*
6. Provide TA and training to TDHCA and TDRA staff on the real estate development process, single family underwriting, and asset/land bank management *18 days*
7. Provide TA and training on both initial inspections and closing inspections *5 days*
8. Provide TA as need on DRGR *5 days*
9. Provide opportunities for guided problem solving to increase the staff knowledge of NSP rules and solutions.
10. Provide training on cross-cutting requirements to subrecipients, including Section 3; Environmental; 504/ADA; Affirmative Marketing; UAR; and procurement. *30 days*
11. Provide marketing training to subrecipients. *8 days*
12. Provide land bank management training to subrecipients. *2 days*

14. RECOMMENDED TA TEAM MEMBER SKILLS & EXPERTISE

Lead consultant – The lead consultant will also act as a NSP resource person for the state staff. As such, they should be high-level, preferably with experience in not only NSP but in running or administering CDBG and/or HOME funds. They should also have virtual access to a cadre of experts in specific areas, and be able to act in concert with the NSP Program Manager.

Project Management consultant – the PM consultant must have significant experience and

expertise in project feasibility analysis, underwriting and construction management. An understanding of Texas’s particular construction environment will be important.

Circuit Rider(s) - the person should have a strong background in program design, an understanding of micro-markets and market analysis, knowledge of NSP and the ability to assist diverse communities move programs forward.

Other TA providers: The state needs help with NSP implementation in several different categories though it is to be determined how the technical assistance will be provided whether on-site, off-site (in other location in region) or on-line. TA is needed from individuals with expertise in the following areas:

Marketing of properties – An individual with residential real estate experience to help devise marketing strategies for homes rehabilitated with NSP funds.

Landbank management – An individual familiar with the landbanking process generally and under NSP specifically.

Environmental – An individual with expertise in delivering environmental training as well as the ability to work one on one with staff in reviewing environmental documents.

Cross-Cutting Requirements – the provision of the existing Cross-cutting requirements training by those experienced in its delivery.

Underwriting – An individual or team of trainers with significant experience underwriting projects in both rural and urban areas.

15. RECOMMENDED TA SCHEDULE/KEY STEPS

Milestone:	Date
State deadline for subrecipients to be 70% expended	February 28
Work plan approved by HUD	March 8
Provider assesses progress and reports to HUD	Every 30 days
Assignment of lead consultant and primary TA team	March 15
Convening of TA team and state’s NSP team to clarify work roles and responsibilities.	March 22
Establish a schedule of regular NSP team and individual meetings to keep work on track, increase knowledge and familiarity with NSP updates and issues ensure any implementation issues are identified early.	March 22
Prepare a schedule of specific training sessions and make determination with HUD as appropriate whether training should be provided remotely, off-site (typically at a location in the region) or on-site.	March 29
Ongoing support to state and subgrantees through TA team	March 15- June 15
Provide TA (likely remote) on DRGR process as needed.	March 15- June 15


Provide TA and training on NSP to staff in areas of tenant rights, eligible costs, eligible uses, income documentation, other NSP rules and HOME overlay as requested by grantee	March 15- June 15
Provide TA and training to staff in construction project management	April
Provide TA and training on both initial inspections and closing inspections 5 days	April
Provide training on cross-cutting requirements to both staff and subgrantees	April-May
Provide environmental training	May
Provide TA and training to TDHCA and TDRA staff on the real estate development process, single family underwriting, and asset/land bank management	May-June
Provide marketing training to subrecipients.	May-June
Provide land bank management training to subrecipients.	June
Provider reports final progress and recommendations to HUD	June 1

16. APPENDICES

NSP TA Self Assessment from grantee and TA provider	X
Texas Date	X

17. SIGNATURE

This Final Report officially completes Work Plan #TDA074. Signature by the Lead Provider certifies that all tasks have been completed and meet the scope of the Needs Assessment Work Plan as approved by HUD.

	2/15/2011
TA Team Leader Signature	DATE

**INTERNAL AUDIT DIVISION
BOARD REPORT ITEM
MAY 5, 2011**

Presentation and discussion of the status of prior audit issues.

Recommend Action

No action required; information only.

Background

Of the 82 current prior audit issues:

- 17 issues previously reported as “implemented” were verified and closed by internal audit.
 - Community Affairs - Community Services – Issue # 40, 42, 43, 53, 114
 - Community Affairs - Energy Assistance – Issue # 69, 139, 140, 141, 142, 143, 144, 145
 - HOME – Issue # 10
 - Information Systems – Issue # 156
 - Multifamily 9% Housing Tax Credit Program – Issue # 31, 35
- 31 issues were previously reported as “implemented” but have not yet been verified and closed by internal audit.
- 11 issues were recently reported by management as “implemented” and are reflected on the attached list.
 - Community Affairs Community Services – Issue # 46
 - Community Affairs Energy Assistance – Issue # 168, 169, 170, 171
 - Disaster Recovery – Issue # 155, 163
 - Neighborhood Stabilization Program – Issue # 180, 190
 - Program Services – Issue # 166, 167
- 22 issues were reported as “in process of implementation”. We will verify and close these issues when they are reported as “implemented.”
 - Community Affairs Energy Assistance – Issue # 191, 192, 193
 - Compliance & Asset Oversight – Issue # 116
 - Information Systems – Issue # 157
 - Neighborhood Stabilization Program – Issue# 172, 173, 174, 175, 176, 177, 178, 179, 181, 182, 183, 184, 185, 186, 187, 188, 189
- 1 issue was reported as “not implemented.”
 - Disaster Recovery – Issue # 162

Texas Department of Housing and Community Affairs - Detailed Audit Findings

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
27	12/19/2007 Deloitte and Tou	Report to Management- year ending August 31, 2007 Annual independent audit of the Department's general purpose financial statements	Px	12/19/07

Division: Information Systems

Section: Not Selected

Issue: Mitas Vendor Access / Change Management

The Mitas application is supported by a third party vendor, and a formal policy has been created for granting the vendor temporary access to the system. However, there is no formal documentation that can evidence management approval and successful testing within a test environment before a change is made by the vendor in the production environment.

Recommendation

Emails or other formal documentation should be retained to evidence testing and approvals for all production changes to the Mitas application.

Status:

- 02/16/10 - On February 29, 2008, Information Systems Division (ISD) updated the applicable written procedures to include the exact process for using the shared email folder to document management approval and successful testing of vendor changes. Financial Administration received and approved the changes on March 19, 2008. These procedures are implemented.
- 09/17/09 - Auditors read issue to be partially verified as implemented by Deloitte and still need verification for the following:

"there is no formal documentation that can evidence management approval and successful testing within a test environment before a change is made by the vendor in the production environment."
- 06/26/08 - Reported to Board as Implemented per Management.
- 04/22/08 - On February 29 2008, Information Systems Division (ISD) updated the applicable written procedures to include the exact process for using the shared email folder to document management approval and successful testing of vendor changes. Financial Administration received and approved the changes on March 19, 2008. These procedures are implemented.
- 12/19/07 - On December 18, 2007, the Information Systems Division (ISD) created a shared email folder to house correspondence related to Mitas system access, testing, and software changes. Mitas system users and ISD staff are able to copy email correspondence to this folder. By January 31, 2008, the Financial Administration Division and ISD will update the applicable written procedures to include the exact process for using the folder to document management approval and successful testing of vendor changes.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
39	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 10/1/2008

Division: Community Affairs

Section: Community Services - CSBG

Px 06/11/08 10/1/2008
Px 12/01/08 2/20/2009
Ix 06/15/09

Issue: Chapter 2-A
The Contract System Should Track Budget Information for Subrecipients

The budgets that subrecipients submit at the beginning of the program year are not included in the automated contract system used to track the subrecipients' expenditure reports. In addition, the percentage of actual funds expended is not calculated and compared to the budget. This causes a problem because once a budget is approved, subrecipients can spend money from any budgeted line item as long as they do not exceed the total amount they were awarded. As a result, there is less accountability for the accuracy of budget projections and for actual expenditures compared to budgeted amounts. In addition, the "other" category of expenses includes direct services and many other types of expenses that should be further separated into line items. The purpose of comparing budgeted amounts to actual expenditures is to help program staff assess the ongoing status of the subrecipient contracts, not to identify unallowable expenditures.

The Community Affairs Division's Comprehensive Energy Assistance Program utilizes an expenditure report that includes budget information.

Recommendations

- o Budgets should be entered into the contract system at the budget line item level in order to ensure that subrecipients are not exceeding their approved budget amounts for any of the budgeted line items.
- o The percentage of actual funds expended should be calculated in the contract system and compared to the budgeted amount for each line item.
- o Line items should be created to address the most common expenditures now included in the "other" category.

Status:

- 06/15/09 - CS staff currently enters the CSBG budget category information in the note section of the CSBG contract system. Documentation related to expenditures reviews, which may have excess cash issues, are filed in T:\ca\all ca scanned\cacs scanned\Monitoring & Working Files\CSBG\2009\Expenditure Reviews. CSBG statute allows flexibility in the use of funds to support operations and has no restrictions or caps on specific budget categories.
- 12/01/08 - Community Services staff will enter the CSBG budget category information in the Community Affairs Contract System in the "Notes" section beginning in FY 2009. Documentation related to expenditures reviews, will be filed: T:\ca\all ca scanned\cacs scanned\Monitoring & Working Files\CSBG\2008\Expenditure Reviews. The CSBG statute allows great flexibility in the use of funds to support operations and has no restrictions or caps on specific budget categories.
- 06/11/08 - Management agrees that the existing system and processes used to monitor CSBG expenditures needs to be altered to address these recommendations. It is important to note that the Department has limited ability to disapprove CSBG expenditures or deny requests to modify the CSBG budget if the activities are defined as allowable in the CSBG Act. Staff will expand the existing monitoring instrument to address this concern and provide training and technical assistance to subrecipients regarding budget preparation for those subrecipients that repeatedly change the CSBG budget.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
41	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 8/15/2008
Division: Community Affairs			Px	12/01/08 3/31/2009
Section: Community Services - CSBG			Ix	06/15/09

Issue: Chapter 3-A:
Inconsistencies in the Disposition of Monitoring Issues Should Be Addressed

We reviewed the monitoring files for fiscal years 2006 and 2007 for a sample of five subrecipients and found that there were inconsistencies in how errors were identified and categorized by the program officers who monitor the subrecipients. The program officers document the issues they identify during on-site monitoring visits in one of three ways: findings, recommendations or notes. Findings identify actions that do not comply with grant requirements and must be addressed by the subrecipient and resolved to the satisfaction of Community Services. Recommendations are preferences suggested by Community Services, but do not necessarily require a change in the subrecipient's procedures. Notes are used to document a condition, but do not include a recommendation for resolution.

There are inconsistencies in the assignment of the status of findings, recommendations or notes. For example, the CSBG does not allow the payment of late fees using grant funds. For one subrecipient we reviewed, the payment of late fees was reported as a finding. For another subrecipient, it was not reported at all. Prior findings identified during a previous on-site monitoring visit that were still outstanding during the next on-site monitoring visit were reported as a finding for one subrecipient, and as a note for another.

Recommendation
Community Services management should provide program officers with a guide for the designation and disposition of common issues to generate more consistent reporting.

Status:

- 06/15/09 - Staff has developed a Monitoring Guide which includes standard language for common monitoring issues. The Monitoring Guide was reviewed by Energy Assistance Section, Community Services Section, and Portfolio Management and Compliance Division. Program officers received training May 14, 2009 on the Monitoring Guide. The Texas Administrative Code was revised to include the definition of a finding, recommendation and note. The Monitoring Guide is currently being reviewed by Executive Management.
- 12/01/08 - Monitoring staff have developed a draft Monitoring Guide which includes standard language for common monitoring issues. Staff will finalize by 3/31/09. Additionally, the draft Monitoring Guide will be reviewed by Energy Assistance Section and Portfolio Management and Compliance Division. Annually, program officers will receive training on the Monitoring Guide.
- 06/11/08 - Management will develop a uniform definition for what constitutes a Finding, a Recommended Improvement and a Note that will be included in a Monitoring Guide Book for monitoring that outlines standard language for most commonly identified issues. The Project Manager for Monitoring will provide training to the Program Officers prior to each monitoring cycle to ensure a clear understanding of the Monitoring Guide Book. During the review of draft monitoring reports, the Project Manager will ensure adherence to the Monitoring Guide Book

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
44	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/30/2008
			Px	12/01/08 5/31/2008
			Ix	06/15/09

Division: Community Affairs

Section: Community Services - CSBG

Issue: Chapter 3-D
Monitoring Reports Need to Be Completed on a Timely Basis

Community Services' monitoring policies and procedures require that subrecipients receive a written monitoring report within 30 days for CSBG on-site monitoring visits or within 45 days for joint CSBG and Comprehensive Energy Assistance Program (CEAP) on-site monitoring visits. For the 31 on-site monitoring visits performed in fiscal year 2007, 18 reports (58%) were not sent out within the required timelines. The subrecipients are required to respond to the monitoring findings within 30 days, or 45 days for joint monitoring visits. If additional responses are needed, the subrecipient has 15 days to submit their follow-up responses. However, these responses are often not received for months.

For the 31 on-site monitoring visits performed in fiscal year 2007:

- One notification letter was not sent to the subrecipient, and 11 of the 31 required notification letters were sent late (35%) and did not provide the suggested 30 days notice prior to a monitoring visit;
- Review of the report was not documented on a review coordination sheet for five of the 31 visits (16%); and
- Twelve of the 31 reports (39%) were not sent to the subrecipients' governing boards as required.

Recommendation

Community Services' policies and procedures should be reviewed, revised and followed to ensure that monitoring reports are timely, are reviewed internally and are communicated to the subrecipients' governing boards as required.

Status:

- 06/15/09 - Staff developed a Monitoring Guide which includes standard language for common monitoring issues. Staff finalized the Monitoring Guide May 2009. The Guide thoroughly addresses documentation standards. The Monitoring Guide was reviewed by Energy Assistance Section, The Community Services Section, and Portfolio Management and Compliance Division. Community Services monitoring tracking system was updated to allow staff to enter the contract numbers. Additional modifications to that system are still needed. Program officers received training on the Monitoring Guide in May 2009. Monitoring procedures have been revised to allow 45 days. Instead of 30 days for the Department to issue the monitoring report and 45 days for the subrecipient to respond. Energy Assistance and Community Services will continue to work with Information Systems to modify the monitoring tracking systems so that more useful reports such as tracking deadlines are developed.
- 12/01/08 - Monitoring staff have developed a draft Monitoring Guide which includes standard language for common monitoring issues. The Guide will more thoroughly address documentation standards. Staff will finalize by 3/31/09. Additionally, the draft Monitoring Guide will be reviewed by Energy Assistance Section and Portfolio Management' and Compliance Division. The Monitoring Tracking System will be updated to generate more useful reports to alert staff about approaching deadlines. Information Systems anticipates modifications to be completed 5/31/09. Annually, Program officers will receive training on the Monitoring Guide. Monitoring procedures have been revised to allow 45 days, instead of 30 days for the Department to issue the monitoring report and 45 days for the subrecipient to respond.
- 06/11/08 - Management will review and revise the Monitoring Standard Operating Procedure to more thoroughly address the recommendations in regards to timeliness of reports and correspondence, documentation of internal reviews, and communication with subrecipients' governing boards. Consistency between policies will be improved and controls will be put in place to ensure these processes are followed. Additionally, the existing monitoring tracking system will be updated to generate more useful reports to alert staff about approaching deadlines.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
45	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/1/2008
			Px	12/01/08 3/31/2009
			Ix	06/15/09

Division: Community Affairs

Section: Community Services - CSBG

Issue: Chapter 3-E
All Program and Expenditure Requirements Need to Be Reviewed During Monitoring Visits

Generally, all program and expenditure requirements are considered during on-site monitoring visits. However, we compared the contract, rules, grant requirements and monitoring instruments used by the program officers during on-site monitoring visits and noted the following issues:

- One of the questions on the monitoring instrument, "Does the subrecipient maintain procedures which conform to the uniform administrative requirements?" has "not applicable" for the CSBG program. However, the CSBG contract states, "Except as expressly modified by law or the terms of this contract, subrecipient shall comply with the cost principles and uniform administrative requirements set forth in the Uniform Grant Management Standards, 1 T.A.C. Sec. 5.141 et seq."
- The monitoring instrument does not prompt program officers to ensure that the expenditures submitted by subrecipients as support for costs are expenditures that were incurred during the contract period. Section 4 of the contract states that the "Department is not liable to Subrecipient for any cost incurred by Subrecipient which is not incurred during the Contract period."
- A review is not performed to determine if the subrecipient's board-approved travel policies were provided to Community Services prior to the subrecipient incurring travel costs.
- Program officers do not review to ensure that the programs and services listed in the subrecipients' CAP plan are actually provided.
- There is no standard form for the program officers to use in documenting the results of their expenditure review.

Recommendations

Program officers should review programs and expenditures during on-site monitoring visits to ensure that subrecipients are complying with the Uniform Grant Management Standards, costs are incurred during the contract period, and subrecipients are providing the programs detailed in their CAP plan.

The program officers should ensure that subrecipient's board-approved travel policies are provided to Community Services prior to incurring any travel costs.

A standard form should be developed to document the results of the expenditure review

Status:

- 06/15/09 - Section 6A of the 2008 ESGP contract has been revised to include reference to the Uniform Grant Management Standards (UGMS) and to address inconsistencies in references. The monitoring instruments were revised to address time period of expenditure reviews. Management will institute controls to ensure that the monitoring instrument is properly completed. 10 TAC §5.2 was codified in March 2009, and states that subrecipients must comply with UGMS and the OMS circulars Subrecipients were requested to submit a current board approved travel policy and are on file.
- 12/01/08 - Section 6A of the 2008 ESGP contract has been revised to include reference to the Uniform Grant Management Standards (UGMS) and to address inconsistencies in references. The monitoring instruments will be revised to address time period of expenditure reviews. Management will institute controls to ensure that the monitoring instrument is properly completed. The Texas Administrative Code Rules 10 TAC §5.2 which will be codified in January 2009 state that subrecipients must comply with UGMS and the OMS Circulars. Subrecipients will be requested to submit a current board approved travel policy by 3/31/09.

<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
06/11/08 -		<p>Management acknowledges inconsistencies in the CSBG and ESGP contracts and the corresponding monitoring instruments. The current contracts reference the Uniform Grant Management Standards (UGMS) and the Office of Management and Budget (OMB) Circulars and the monitoring instruments only reference the OMB Circulars. Management will update the contracts and monitoring instruments to include references to UGMS and the OMB Circulars.</p> <p>The Department will continue to review the monitoring instrument and consider strengthening the review process. The monitoring instrument will be revised to indicate that expenditures reviewed are within the contract period and other changes to the instrument made so that wording of questions better addresses risks and that appropriate follow up occurs for questions. Staff will be trained on the instrument and its changes. Further, controls will be put in place to ensure the monitoring tool is being properly completed (i.e. peer reviews or similar solution.)</p> <p>Management will request a board-approved travel policy from each CSBG subrecipient to maintain in an electronic file at the Department. If a subrecipient changes their travel policy, the subrecipient will be required to submit a new policy to the Department. A standard form, or similar effective tool, will be developed to document the results of the expenditure review.</p>

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
46	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 10/31/2008

Division: Community Affairs

Section: Community Services - CSBG

Issue: Chapter 3-F
The Monitoring Tracking System and the Risk Assessment Process Should be Updated and Improved

All subrecipients are required to have an on-site monitoring visit at least once every three years, and Community Services does a good job of ensuring that these reviews take place. Community Services uses a risk assessment process to determine which subrecipients to monitor each year. They use the Department's standard risk assessment module and rely on an automated monitoring tracking system to track the number, type, and status of findings reported as a result of on-site monitoring visits. The information from the monitoring tracking system is used to complete the risk assessment module. However, the monitoring tracking system is not being kept up to date. As a result, the system can not be relied upon in completing the risk assessment process, and staff must manually go through monitoring reports to determine the information they need for the risk assessment. In addition, the risk assessment does not capture all of the information needed to accurately determine risk.

In comparing the information contained in the monitoring tracking system to the information gathered from manually reviewing monitoring reports and responses, of the 65 on-site monitoring visits performed over the past two years:

- The information contained in the system matches the information in monitoring reports and responses for 16 visits (24.6%),
- The information contained in the system is incomplete when compared to the monitoring reports and responses for 34 visits (52.3%) and inaccurate for one visit, and
- There is no record of 14 monitoring visits (21.5%) in the monitoring tracking system.

Of the 453 questions answered in the 2006 risk assessment, 83 questions (19.6%) were answered incorrectly or not at all. In addition, the possible answers to the risk assessment questions do not provide an accurate assessment of which subrecipients pose the highest risk. For example:

- A subrecipient with one previous monitoring finding currently receives the same ranking as a subrecipient with multiple findings on a previous monitoring report.
- A subrecipient that has never been monitored is currently ranked higher for the question 'time since last on-site visit', but is rewarded by receiving no points for the questions 'results of last on-site visit' and 'status of most recent monitoring report.'
- A subrecipient can be delinquent in providing their audited annual financial report to the Department for multiple months, but if they are in compliance on the day the risk assessment is completed, they are ranked the same as an entity who was in full compliance with the audit requirement throughout the year.

Recommendations

Community Services should:

- Revisit the use of the monitoring tracking system for tracking the findings resulting from on-site monitoring visits. This should be done before additional resources are spent in improving or maintaining the current system. If the monitoring tracking system is used, Community Services should develop processes to ensure that data entered into the system is complete and is periodically compared to the data in the monitoring files
- Develop a process or a database that will track the data used in the Department's risk assessment module, and
- Further develop answers to the questions in the risk assessment in order to produce a more accurate risk ranking of the subrecipients.

Px	06/11/08	10/31/2008
Px	12/01/08	5/31/2009
Dx	06/15/09	
Dx	09/21/09	
Nr	03/01/10	
Px	07/13/10	12/31/2010
Px	10/28/10	12/31/2010
Px	01/10/11	2/28/2011
Ix	04/21/11	

Status:

- 04/21/11 - The Monitoring Tracking Database has been implemented and is being used by all Community Services monitoring staff. This Database provides Program Officers and management the ability to update and track the status of monitoring visits, findings, reports, and responses. As previously noted, the Information Systems Division has determined that the existing database and risk assessment will not be able to be used as intended. The CS Section has modified a monitoring tracking system used by the Community Affairs Division Energy Assistance Section to meet CS needs. The Risk Assessment has been modified to take the IA concerns into account.
- 01/10/11 - The Information Systems Division has determined that the Monitoring Tracking System will not be able to be used as intended. The Risk Assessment will not be able to pull data electronically from the Monitoring Tracking System as intended. The IS Division has been and is currently working on ARRA projects which are assessed as a higher priority to the Department. Community Services will modify a tracking system developed by CAD/Energy Assistance Section. Once it is modified to meet CS needs, the data related to the monitoring of CS contracts will be entered. The system is an Access based database. This database is in the final stages of completion, however due to a family emergency, the staff member responsible for implementation of this task was out for three weeks and unable to complete on schedule. Barring further unexpected obstacles, this task will be completed by 2/28/2011.
- 10/28/10 - The Information Systems Division has determined that the Monitoring Tracking System will not be able to be used as intended. The Risk Assessment will not be able to pull data electronically from the Monitoring Tracking System as intended. The IS Division has been and is currently working on ARRA projects which are assessed as a higher priority to the Department. Community Services will modify a tracking system developed by CAD/Energy Assistance Section. Once it is modified to meet CS needs, the data related to the monitoring of CS contracts will be entered. The system is an Access based database. This database should be modified to meet CS needs by 12/31/2010 and thereafter monitoring data will begin to be entered into the system.
- 07/13/10 - The Information Systems Division has determined that the Monitoring Tracking System will not be able to be used as intended. The Risk Assessment will not be able to pull data electronically from the Monitoring Tracking System as intended. The IS Division has been and is currently working on ARRA projects which are assessed as a higher priority to the Department. IS staff has also recommended not modifying what had been developed. Community Affairs Community Services will work with IS on this project once other pressing IS/CACS projects are finalized and IS has time available to determine what system can be developed to assist with the Risk Assessment. Community Services is considering developing either an Access or Excel database to manage data for the Risk Assessment and not relying on the IS database.

CS is in the process of entering monitoring data related to monitoring reviews and anticipates completing this by 12/31/2010. CSBG Program Officers have also had additional work related to the CSBG ARRA program. CSBG ARRA contracts will end 9/30/2010.

03/01/10 -

09/21/09 - Information Systems has made modifications to the monitoring tracking system but additional modifications are needed, The IS Division is currently working on projects assessed as higher priority to the Department.

06/15/09 - Information Systems has made modifications to the monitoring tracking system but additional modifications are needed. The IS division is currently working on projects assessed as higher priority to the Department. The IS division has set the incorporation of the American Recovery and Reinvestment Act contracts and reporting mechanism into the current Community Affairs contract system as a high priority.

12/01/08 - The Information Systems Division has made modifications to the Monitoring Tracking System but additional modifications are needed and will be completed by 5/31/09.

06/11/08 - The CA Division in conjunction with the IS Division will revisit and update the monitoring tracking system that tracks monitoring findings. A CS staff member, who is not required to travel, will be designated to maintain the monitoring tracking system. The existing monitoring tracking system tracks data used in the Department's Risk Assessment Module. Management will ensure that data is entered in a timely manner.

Prior to the 2008 Risk Assessment, questions and weights were revised to reflect a more accurate risk ranking of the subrecipients. The Risk Assessment will continue to be evaluated and improved.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
47	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 10/1/2008

Division: Community Affairs

Section: Community Services - CSBG

Px 06/11/08 10/1/2008
Px 12/01/08 3/31/2009
Ix 06/15/09

Issue: Chapter 4-A
Community Services Should Review Underlying Data to Ensure That Performance Measures are Correct

Program officers are not required to review the supporting documentation (or even the supporting documentation for a sample of clients) to ensure that the subrecipients are correctly reporting the number of individuals transitioning out of poverty. This number is defined as the number of individuals achieving incomes above 125% of the poverty level.

Four out of the nine LBB performance measures for Community Services use this data in their calculations and of these four, three are key measures for the Department.

The number of individuals transitioning out of poverty is important because it is used as part of both the ROMA and the LBB performance measures, and is used to determine the amount of discretionary funds paid to subrecipients in the form of performance awards. (see Chapter 4-B) The definitions and methods of calculation for this measure do not require the Department to verify the data submitted by the subrecipients; however, the LBB's performance measures guidance requires the Department to have sufficient controls in place to ensure the accuracy of the data. Without the control of testing or verifying at least a sample of the underlying data, it is not possible for the Department to ensure that the data is accurate.

Recommendations

- When reviewing a sample of client files during monitoring visits, program officers should re-calculate the reported incomes using the supporting documentation in the client file to confirm that clients who were reported as transitioning out of poverty really did so, and that only allowable income is considered.
- Community Services should develop and enforce a standard methodology for calculating income to ensure consistent and comparable results.

Status:

- 06/15/09 - The CSBG monitoring instrument was revised in May 2009 to clarify the verification of the allowable income of clients that transitioned out of poverty and other CSBG clients. A new attachment was created for the review of CSBG case management files and to review income documentation for households transitioned out of poverty.
- 12/01/08 - The CSBG monitoring instrument will be revised to clarify the verification of the allowable income of clients that transitioned out of poverty and other CSBG clients.
- 06/11/08 - The current process will be reviewed by Management and the Community Services Block Grant monitoring instrument will be revised to clarify the verification of the allowable income of clients that transitioned out of poverty and other CSBG clients.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
50	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 1/1/2010

Division: Community Affairs

Section: Community Services - CSBG

Issue: Chapter 5-A
Only Eligible Administrative Costs Should Be Charged to the Emergency Shelter Grant Program

Currently, all work performed by the ESGP staff is charged to the grant. This means that staff is charging the time they work on developing the Consolidated Plan to the ESGP's administrative funds. However, the U.S. Department of Housing and Urban Development (HUD), which administers the ESGP, states that ineligible administration costs include the preparation of the Consolidated Plan and other application submissions.

The Consolidated Plan serves as the state's application to the federal Government for ESGP funds. The plan states how the Department will pursue the goals of decent housing, a suitable living environment and expanded economic opportunities for all community development and housing programs.

Recommendation

The Department should find an alternate fund to which staff can charge the work performed on the Consolidated Plan.

Status:

- 12/01/08 - Staff has changed the process for allocating staff time associated with the HUD Consolidated Plan whereby ESGP funds are not charged for preparation of the Plan.
- 06/11/08 - The Department will utilize an eligible source of funds to develop the Emergency Shelter Grants Program portion of the 5 Year Housing and Urban Development Consolidated Plan, which includes work on the Annual Action Plan and Consolidated Annual Performance Evaluation Report (CAPER). CS staff will allocate time related to the development of the 5 Year HUD Consolidated Plan to an eligible source of funds.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
51	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/1/2008

Division: Community Affairs

Section: Community Services - CSBG

Issue: Chapter 5-B
The Methodology Used for Subrecipient Payments Should Ensure Consistency and Compliance with the Contract

The ESGP contract states that the subrecipient may request advance payment by submitting a properly completed monthly report to the Department. According to the HUD ESGP Program Guide, either cost reimbursement or advance payments can be used, depending on how the funds are handled. The CFR (24 CFR 85.20) states that, "Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and sub grantees must be followed whenever advance payment procedures are used." Program staff state that the program is set up on a cost reimbursement basis and advance payments are not made. However, a review of one subrecipient indicates that they are making cost projections and receiving advance payments.

Recommendation

The Department should review the requirements and benefits of both the advance payment and cost reimbursement methodologies and determine which one to use. The contract and other written guidelines should be revised to ensure consistency with the chosen method.

Status:

12/01/08 - The 2008 ESGP contract was revised to only allow a one time advance payment.

06/11/08 - Management will review and ensure that the language in the Emergency Shelter Grants Program (ESGP) contract is consistent with the Housing and Urban Development ESGP Program Guide that allows for either cost reimbursement or an advance method of payment. A set of risk criteria will be established, and the payment method allowed for each subrecipient will be based on the level of risk. Staff will be trained to use the risk criteria to determine the appropriate method of payment for an ESGP subrecipient.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
52	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 12/31/2008
			Px	12/01/08 3/31/2009
			Ix	06/15/09

Division: Community Affairs

Section: Community Services - CSBG

Issue: Chapter 6-A
The Processes Used to Document and Communicate Monitoring Results Should Be Revised

There are inconsistencies in the manner in which program officers determine which issues are identified as findings and reflected in the final monitoring report and which issues are resolved on-site by the program officers via technical assistance and are not reflected in the report. During a review of the monitoring reports and monitoring instruments of multiple subrecipients, the same issue was reported as a finding in one report, while in another report it was documented as a recommended improvement. Recommended improvements do not require the subrecipient to respond to Community Services on how the issue will be corrected. Also, instances were noted where an issue was documented as a finding on the original monitoring instrument and then changed to a recommended improvement without documenting the reasons for the change.

The program officers who monitor the ESGP subrecipients complete a standard monitoring instrument during on-site monitoring visits. However, the monitoring instrument is not always entirely completed, nor is the monitoring information correctly posted to the monitoring tracking system.

We tested the monitoring files for 26 of the 76 subrecipients in program year 2006 and found that:

- three of 26 the subrecipient files did not contain any monitoring documents for the program year 2006 monitoring visit,
- 12 of the 23 subrecipient files for which documentation of a program year 2006 monitoring visit was available, did not have the monitoring instrument fully completed by the program officer during the monitoring visit,
- 13 of the 26 ESGP monitoring files were not posted to the monitoring tracking system and an additional 6 were not posted correctly, and
- 19 of the 26 monitoring files did not contain a cumulative inventory report, which is required by the ESGP contract and should be submitted to Community Services by October 31st.

The ESGP policies and procedures require that the monitoring reports be sent to the subrecipients within 30 days of the monitoring visit, and that the subrecipients provide written responses to the findings within 30 days from the date of the report. If additional responses are needed, the subrecipients have 15 days to submit their follow-up responses. Follow-up letters requesting additional responses must be sent within 30 days from the date of the original monitoring response, or, if no additional responses are needed, the letter sent to close out the monitoring report must be sent within 30 days of the date of the responses.

- 16 of the 23 subrecipient monitoring files did not contain evidence that the monitoring reports were sent to the subrecipient on a timely basis,
 - six of the 23 subrecipients did not submit their monitoring responses within the required 30 days,
 - three of the 6 subrecipients who were required to submit additional responses did not submit the additional responses within the required 15 days, and
 - 11 of the 23 subrecipient monitoring files tested indicated that the follow-up or closeout letters were not sent within 30 days as required.
- Four of the 23 subrecipient files did not have close out letters in the file, so it is unclear whether these monitoring reports were closed.

Recommendation

Community Services should develop processes to ensure that:

- Program officers are consistent in determining what issues are identified as findings and what issues are identified as recommended improvements,
- Monitoring files contain support for monitoring visits,
- Monitoring instruments are properly completed,
- Information entered into the monitoring tracking system is verified against the information in the monitoring files, and
- Correspondence and reports are sent to subrecipients on a timely basis.

<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
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Status:

- 06/15/09 - Staff has developed a Monitoring Guide which includes standard language for common monitoring issues. Monitoring Guide was reviewed by Energy Assistance Section, Community Services Section, and Portfolio Management and Compliance Division. Program officers received training May 14, 2009 on the Monitoring Guide. The Texas Administrative Code 10 TAC §5.16 was revised to include the definition of a finding, recommendation and note. Monitoring Guide is being reviewed by Executive Management. Procedures for support documentation have been revised to ensure that monitoring files are complete and that monitoring instruments are properly completed. Monitors are required to verify information entered into the monitoring tracking system coincides with information in the monitoring files. Monitors will be required to send correspondence and reports to subrecipients on a timely basis.
- 12/01/08 - Monitoring staff have developed a draft Monitoring Guide which includes standard language for common monitoring issues. The Program officers received training on the Monitoring Guide and for what is considered a finding, recommended improvement, a note, and standard language for common findings. Staff will finalize by 3/31/09. Additionally, the draft Monitoring Guide will be reviewed by Energy Assistance Section and Portfolio Management and Compliance Division.
- 06/11/08 - 06/11/08 - Management will develop a uniform definition for what constitutes a Finding, a Recommended Improvement and a Note that will be included in a Monitoring Guide Book that outlines standard language for most the commonly identified issues. The Project Manager for Monitoring will provide training to the Program Officers prior to each monitoring cycle to ensure a clear understanding of the Monitoring Guide Book. During the review of draft monitoring reports, the Project Manager will ensure adherence to the Monitoring Guide Book. The CS Project Manager for Monitoring, responsible for ESGP, will provide training to Program Officers to ensure that monitoring files contain adequate support documentation and monitoring instruments are properly completed.

The CA Division in conjunction with the IS Division will revisit and update the monitoring tracking system that tracks monitoring findings. A CS staff member, who is not required to travel, will be designated to maintain the monitoring tracking system.

Management will provide training and oversight to ensure that staff adheres to the existing Monitoring Standard Operating Procedure in regards to timeliness of reports and correspondence, documentation of internal reviews, and communication with subrecipients' governing boards. The existing monitoring tracking system will be updated to generate more useful reports to alert staff about approaching deadlines.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
55	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/1/2008

Division: Community Affairs

Section: Community Services - CSBG

Issue: Chapter 6-D
Subrecipients Should Document the Review of Client Eligibility Prior to Providing Funding for Essential Services

Two of the four categories of ESGP funds, homeless prevention funds and essential services funds are used to assist clients. Most ESGP clients receive homeless prevention services which consist of rent or utilities payments, or other services paid for with ESGP funds to prevent homelessness. Most of the essential services funds are used for subrecipient administration, but some clients receive funds from essential services, which are payments made directly to the client for things like bus tokens, job training or medical and psychological counseling. The subrecipients are not required to retain completed intake forms for clients that receive essential services, and program officers do not review client files to determine if the clients who received these funds were eligible.

Recommendation
Eligibility should be reviewed, documented and retained for all clients who receive essential services.

Status:

- 07/13/10 - The ESGP Monitoring Instrument was revised in 2008 and additional revisions were made 7/1/2010 to address the need for program officers to review eligibility documentation and to ensure such is maintained by subrecipient for clients receiving ESGP funded essential services.
- 03/22/10 - Internal Audit received a portion of the 2008 ESGP Monitoring Instrument marked specifically for Chapter 6-D, with an asterisk by the statement that reads "41. Is there a system of control for the accounting of vouchers, bus tickets, and other direct services provided with ESGP funds?" While the auditor understands this to be a way to maintain documentation of the essential services provided, the recommendation specifically asks that eligibility should be reviewed, documented, and retained for all clients receiving essential services. The auditor would need to see where eligibility is maintained for each client.
- 06/17/09 - ESGP Monitoring instrument was revised to indicate client eligibility requirements.
- 06/12/09 -
- 12/01/08 - The ESGP Monitoring instrument will be revised to affirm the eligibility of clients for essential services.
- 06/11/08 - Intake forms are currently required for homelessness prevention services provided directly to the clients such as rental subsidies and utility payments. When subrecipients provide essential services that include food, bus tokens and personal hygiene items (such as soap and shampoo), subrecipients maintain a log detailing client names. However, staff will improve on this tool so that it has the ability to affirm eligibility of clients for essential services.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
65	5/6/2009 Internal Audit	Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Division The scope of this audit included the loan document processing and loan servicing functions	Px	05/06/09
			Ix	06/11/09

Division: HOME

Section: HOME Production

Issue: Chapter 3-B
Condition: A certificate of completion or other evidence that verified the completion of construction was not included in eight of the 15 files (53.3%) reviewed.
Cause: Construction loans are forgiven based on a pre-determined date, rather than evidence that the construction is complete.
Criteria: To ensure loan provisions are satisfied, completion of construction should be documented prior to loan forgiveness.
Effect: Without some proof of the completion of construction, the Department could forgive a loan on a property before it is finished.
Recommendation: The Department should:
• ensure that the term of the unsecured equity loan is sufficient to guarantee completion of construction prior to the loan maturity date, and
• obtain and include in the loan servicing file the documentation verifying the completion of construction.

Status:

- 06/11/09 - To ensure loan provisions are satisfied and completion of construction is documented prior to loan forgiveness, the Division has a series of documents required for each loan file. The Department requires Contract Administrators undertaking construction activities execute a Construction Loan Agreement (CLA), which indicates a construction completion date and requires the Owner to acknowledge that before a final disbursement is made under the agreement, the Owner must provide a signed Affidavit of Completion, Form 11.27 the Department. In addition to the CLA, Division staff verifies construction completion of the housing unit by requiring Department Form 11.03-Final Inspection, which inspects housing conditions for compliance with applicable construction standards, specifications, and codes. This information is reviewed and provided as support documentation prior to the Final Draw Request Checklist--Form 16.26 and release of funds from the Department. Finally, in order to evidence both the construction completion date and loan maturity date, the Department executes a Deed of Trust and Promissory Note with households receiving construction assistance.
- 05/06/09 - Management agrees with the recommendations and will, in the next 90 days be revising the mechanism for forgiveness including documented assurances that the construction has been completed (Lora Myrick)

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
71	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08

Division: Community Affairs

Section: Community Services - CSBG

Px 06/11/08
Px 12/01/08 2/28/2009
Ix 06/15/09

Issue: Chapter 6-E
Standard Forms and Processes Should be Developed to Document the Sample of Expenditures and Client Files Reviewed During Monitoring

There are no written procedures for documenting the shelters visited and expenditures reviewed by the program officers during on-site monitoring visits. In addition, the contract specialist performs reviews of monthly expenditures, but does not document the results of these reviews. Finally, there is no written procedure regarding how many client files should be reviewed during an on-site monitoring visit. For example, one program officer may review 12 client files while at another subrecipient, they may only review three client files.

Recommendation

Community Services should:

- Develop written procedures and standard forms to document the shelters and expenditures reviewed during monitoring visits,
- Maintain documentation to support the review of monthly performance and expenditure data, and
- Develop written procedures regarding the minimum number of client files that should be reviewed in order to ensure consistency between subrecipient monitoring visits.

Status:

- 06/15/09 - ESGP Monitoring Instrument was revised to address identified areas. Additional questions and forms were added to document the review of performance and expenditure data. A minimum of 5% of the client files will be reviewed.
- 12/01/08 - The ESGP Monitoring Instrument and Monitoring SOP will be revised to address identified areas.
- 06/11/08 - Management will expand the Emergency Shelter Grants Program (ESGP) monitoring instrument to document the name and number of shelters visited and to integrate a standard form, including maintaining documentation, for use in reviewing expenditures.

The CS Section will strengthen procedures to document a process for ensuring review of monthly performance and expenditure data.

ESGP Program Officers currently review all client files for the sample months selected.

The Monitoring SOP will be expanded to include a minimum percentage of client files that will be reviewed in order to ensure consistency between subrecipient monitoring visits.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
72	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08

Division: Community Affairs

Section: Community Services - CSBG

Px	06/11/08	
Px	12/01/08	5/31/2008
Ix	06/15/09	

Issue: Chapter 8
There are Advantages and Disadvantages in Changing the Organizational Structure to Separate the Monitoring and Program Support Functions

The program officers who monitor the subrecipients in both CSBG program and ESGP also provide technical assistance to the subrecipients. Technical assistance is provided when the program officer offers advice or suggestions to help improve the subrecipient's operations. Frequently this technical assistance takes place during on-site monitoring visits. Program officers are assigned a group of subrecipients to monitor and these assignments are rotated every three years. The program officers report to a manager who is directly accountable to the director of the Community Affairs Division. The director of Community Affairs is responsible for not only the monitoring of these programs, but for the performance of the programs, too. This model has several advantages and disadvantages.

The advantages are:

- An ongoing working relationship is developed between the subrecipient and the program officer that allows the program officer to become familiar with the operations and the needs of the subrecipients assigned to them,
- Program officers can identify the subrecipients' training needs and work with the trainer assigned to their program to ensure that the subrecipients get the training they need,
- Program officers can develop subject matter expertise in the CSBG program or ESGP, and
- The director of the Community Affairs Division is responsible for all aspects of the programs in the division and can more easily be held accountable for them.

The disadvantages are:

- There is a risk that managers or program officers could be inclined to identify issues as technical assistance or training needs rather than monitoring findings
- Program officers may develop relationships with subrecipients that could contribute to the risk of favoritism, and increase the potential for fraud, waste or abuse,
- The line between training needs and compliance with the laws and rules governing the administration of the grant funds is not clear,
- In the case of CSBG, technical assistance is not currently an allowable cost for the administration funds that pay the program officers' salaries (see Chapter 1-A),
- The director of the Community Affairs Division may not be willing to bring issues with subrecipients forward to executive management or the Department's governing board because they are responsible for the success of the grant programs, and
- The program officers may not have easy access to information gathered by other divisions within the Department, for example, the Portfolio Management and Compliance (PMC) Division (see Chapter 3-B.)

The Department's PMC Division is responsible for monitoring most of the Department's other programs. Combining the Community Affairs Division's program officers' monitoring function with the PMC Division's would have the following advantages:

- Separating the goals of program support and technical assistance from monitoring,
- Decrease the opportunity for collusion, or other types of fraud, waste and abuse, and
- Decrease the number of monitoring visits by coordinating monitoring visits for multiple programs with each subrecipient.

Recommendation

The Department should evaluate the functions and activities of the program officers and other staff of the Community Affairs Division and decide whether to move the monitoring function to another division, or to put into place safeguards to ensure the consistency of monitoring and decrease the potential for collusion or other types of fraud, waste and abuse.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
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Status:

- 06/15/09 - Safeguards have been implemented through the revision of TAC rules, the development of a monitoring guide, revisions to the monitoring instruments, and changes to the monitoring processes to ensure the consistency of monitoring and to decrease the potential for collusion, fraud, waste or abuse.
- 12/01/08 - Safeguards have been implemented through the revision of the TAC rules. the development of a draft monitoring guide, revisions to the monitoring instruments, and changes to the monitoring processes to ensure the consistency of monitoring and to decrease the potential for collusion, fraud, waste or abuse. The CA Division Director will continue to work with the Executive Team to evaluate the effectiveness of the monitoring function in the Community Affairs Division.
- 06/11/08 - Management will evaluate the functions and activities of the program officers and other staff of the Community Affairs Division and decide whether to move the monitoring function to another division, or to put into place additional safeguards to ensure the consistency of monitoring and decrease the potential for collusion or other types of fraud, waste and abuse.

84	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s
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	<u>Status</u>	<u>Target Date</u>
Px	08/18/08	11/30/2008
Px	11/08/08	11/30/2008
Ix	01/21/09	

Division: Information Systems

Section: Not Selected

Issue: Chapter 3-A
The Department Has Not Configured Its Internal Accounting System to Maintain Audit Trails

Although the Department controls access to the MITAS System through the use of user logins and passwords, it has not enabled the audit trail feature in the MITAS System. The MITAS System is the Department's internal accounting system for the Program; it contains general Program loan information, but it does not contain specific confidential information of Program borrowers. The MITAS System is an accounting software package the Department purchased from the MITAS Group. Audit trails maintain a transaction and logging history for a system. Without audit trails, the Department cannot consistently identify who created a transaction or changed data or when the activity occurred. This weakness may hinder any Department efforts to identify and resolve the source of errors or unauthorized changes to its data.

If unauthorized changes are made, it may limit the Department's ability to identify the source of the change and accurately reconcile Program funds. The Texas Administrative Code requires agencies to maintain appropriate audit trails based on a documented security risk assessment.

Recommendation
The Department should perform a risk assessment to determine whether it should enable the audit trail function in the MITAS System and implement the resulting decision.

Status:

- 01/21/09 - The department completed the MITAS risk assessment on November 24, 2008, and implemented the resulting audit trail decisions.
- 11/08/08 - The Department is currently performing the Mitas risk assessment and expects to be complete with it and associated audit trail decisions by November 30, 2008. The Department has reconfigured the current server environment to allocate disk space for any required system logging, based on the risk assessment
- 08/18/08 - The Department agrees with the recommendation and will perform a risk assessment to decide whether it should enable the MITAS audit trail function. Because of resource limitations on the server hardware that currently houses MITAS, the Department will also upgrade the hardware to add the disk space required for increased system logging.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
85	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 11/30/2008

Division: Information Systems

Section: Not Selected

Px 08/18/08 11/30/2008
Px 11/08/08 11/30/2008
Ix 01/23/09

Issue: Chapter 3-C
The Department Has Not Conducted a Security Risk Assessment Since 2005

Title 1, Texas Administrative Code, Section 202.25 (1 TAC 202.25), recommends that state agencies adopt 24 security policies and other information technology security controls based on a documented security risk assessment. The Department performed an agency-wide risk assessment in 2005, including an assessment of the security over information systems and its controls over high-impact information system processes. The Department reviewed the controls over these high impact information system processes again in 2006. The Department did not document its reasons for not implementing an information security control and eight of the policies recommended in 1 TAC 202.25. Auditors communicated details of these system security weaknesses to Department management. The Department could improve its information technology security by conducting a security risk assessment and addressing any weaknesses it identifies.

Recommendation

The Department should perform, document, and implement (as appropriate) a security risk assessment.

Status:

- 01/23/09 - On January 23, 2009, the Department completed an updated security risk assessment which addresses controls listed in Title 1, Texas Administrative code, Section 202.25. The risk assessment documents existing and recommended information security policies and other controls and established a target date for implementing each recommendation.
- 11/08/08 - The Department is in the process of performing an updated security risk assessment, which addresses controls listed in Title 1, Texas Administrative Code, Section 202.25.
- 08/18/08 - The Department agrees with the recommendation and has created a security policy upgrade plan which includes the step of performing an updated security risk assessment.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
86	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 10/31/2008

Division: Bond Finance

Section: Not Selected

Issue: Chapter 4
The Department Does Not Include Statutorily Required Language in All Program Contracts

The Program's contracts do not contain the statutorily required language granting the State Auditor's Office audit authority and access to records. These contracts include those with bond counsel, The Bank of New York Mellon Corporation, and Countrywide Home Loans, Inc. Contracts that do not contain this statutorily required language may limit the State's ability to provide effective oversight of contract terms, contractors, and the use of state funds. Access to records is an essential element of auditing. Texas Government Code, Section 2262.003, requires that all state agency contracts contain contract terms specifying that:

- The State Auditor may conduct an audit of any entity receiving funds from the State directly or indirectly under the contract.
- An entity subject to audit by the State Auditor must provide the State Auditor with access to any information that the State Auditor considers relevant to the audit.

These contract language requirements were effective as of September 1, 2003.

Recommendations

The Department should comply with statutory requirements by:

- Amending all current contracts to include terms granting the State Auditor audit authority and access to records.
- Including in all future contracts terms granting the State Auditor audit authority and access to records.

Status:

07/06/10 - TDHCA has added this provision to contracts prepared internally. The Office of the Attorney General prepares all outside counsel contracts and will add this provision to their form. Current bond counsel contract with Vinson & Elkins does not contain this provision but will be added upon renewal in 2011.

The OAG advised that this provision has been a complicated problem. Their current form doesn't include thses provisions because almost all outside counsels objected to it and refused to sign with the provision included. The OAG discussed the matter with the SAO. The decision was made to add the language into future forms and the SAO will field calls if outside counsels object again.

01/21/09 - Amend existing contracts as they are renewed.

11/07/08 - Existing contracts will be amended when they are renewed and all future contracts will contain the language to allow the State auditors office authority and access to records.

08/18/08 - The Department agrees to comply with statutory requirements relating to program contracts. The Department will review and amend all contracts to include terms granting the State Auditor audit authority and access to records as contracts are renewed. The Department has already incorporated Section 2262.003 of the Texas Government Code in the Request for Proposal for Underwriting Services and Request for Proposal for Master Servicer to be presented to the Board at the September 4, 2008 meeting, which included terms granting the State Auditor audit authority and access to records.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
115	6/23/2009 Department of H	Texas Community Services Block Grant Program (CSBG) State Assessment Review Review of the fiscal and programmatic procedures of the CSBG State agency	ix	07/27/09

Division: Community Affairs

Section: Community Services - CSBG

Issue: Finding 4
 •The State needs to ensure that all eligible entities and CAA's are in compliance with the income eligibility requirements for emergency services.
 •We recommend the State:
 o 4.1 Ensures eligible entities and CAA's verify income eligibility requirements for CSBG funded emergency service programs.

Status:
 07/27/09 - Recommendation 4.1: TDHCA does require that CSBG eligible entities document and verify that persons receiving CSBG funded emergency services are income eligible. TDHCA requires that in cases where proof of income is unavailable, a Declaration of Income Statement form be completed and maintained in the applicable client level file. The form requires that the client certify the income of all household members without documentation of income. The program officers review client eligibility documentation in the client files during on site monitoring reviews.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
116	4/17/2009 HUD	Affordable Housing and Financial Monitoring and Technical On-site monitoring of the state's affordable housing programs		

Division: Compliance & Asset Overs

Section: Compliance

Issue: Finding #2 Review of the multifamily portfolio report indicated there are numerous projects that are out of compliance with the HOME Program requirements under §92.503(b). Some of the deficiencies/violations could have serious consequences resulting in the state being requested to repay the full amount of the HOME funds invested if the projects cannot be brought into compliance within a reasonable period of time.

Px 06/30/09
Tx 01/25/10
Px 06/29/10
Px 09/30/10
Px 01/11/11
Px 04/18/11

Required Corrective Action: The state must provide a detailed report for all of the properties listed on the enclosed report. Report must be provided on or before June 20, 2009. The state must then provide a quarterly report beginning on October 10th and thereafter, on or before the 10th of the month for each subsequent quarter beginning January 10th, 2010, until the projects have been brought into compliance.

Status:

- 04/18/11 - The Department's April 2011 quarterly report to HUD indicates eight more properties have resolved their compliance issues. The Department is continuing its efforts to resolve compliance issues at the remaining properties and report quarterly to HUD.
- 01/11/11 - The Department is confident that some of the remaining properties will come into compliance through normal monitoring and enforcement procedures. However, the Department acknowledges that some of these properties need special consideration. TDHCA and HUD regional staff have been discussing dates and times to meet and discuss ideas for resolving these property compliance issues.
- 09/30/10 - Last quarter 2 more properties came into compliance. The Department is confident that some of the remaining properties will come into compliance through normal monitoring and enforcement procedures. However, the Department acknowledges that some of these properties need special consideration. TDHCA and HUD regional staff have been discussing dates and times to meet and discuss ideas for resolving these property compliance issues.
- 06/29/10 - Since the last quarter, 12 more HOME properties have resolved all of their compliance issues. Staff continues to work with owners and report to HUD.
- 01/25/10 - Since the last quarter 24 HOME properties have cleared all of their noncompliance issues. Staff continues to work with HOME properties on corrections and reports to HUD regularly.
- 06/30/09 - The Department is working to bring about restored compliance and achieve required affordability through a combination of thorough and regular monitoring, enhanced technical assistance, the initiation of the administrative penalty process, and informal conferences.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
122	12/18/2008 Deloitte and Tou	Report to Management - year ending August 31, 2008 Annual independent audit of the Department's general purpose financial statements	Px	09/30/09 10/31/2009
			Px	12/18/09 1/31/2009
			Ix	02/16/10

Division: Information Systems

Section: Not Selected

Issue: Observation: The PeopleSoft support team makes changes to financial data stored in the Oracle database after receiving approvals through email by business users. Such requests are entered in Track-It to ensure they are completed timely. Changes made to the production database include SQL queries which update and delete data. Such changes are made through individual user identification to establish accountability on the system. However, such database changes are not logged systematically through individual user accounts to ensure only changes intended by management are made to the production database.

Recommendation: All requests by the business to allow IT support to make data changes should be written, maintained and monitored for appropriateness.

Status:

- 02/16/10 - The reporting mechanism that the Director of Information Systems uses to monitor the direct database change log was put into place in early November 2009. The report can now be run at any time and with any date range to produce a list of direct database changes made to the PeopleSoft Financials 8.8 production environment.
- 12/18/09 - In addition to the current process of documenting Financial Administration (FA) Division management or team leader approval in advance of performing direct database updates in PeopleSoft as requested by FA management and staff, the Information Systems Division will implement a process to log direct database changes made through the individual system accounts of the PeopleSoft support team. The Director of Information Systems will monitor these logs for appropriateness.
- 09/30/09 - The Information Systems Division implemented the direct database change log for PeopleSoft in August 2009. The reporting mechanism that the Director of Information Systems will use to monitor the log will be put into place by October 31, 2009.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
123	12/18/2008 Deloitte and Tou	Report to Management - year ending August 31, 2008 Annual independent audit of the Department's general purpose financial statements	Px	12/31/2008
			lx	09/30/09

Division: Information Systems

Section: Not Selected

Issue: Observation: Policies have been created to govern network and systems software change management. Individuals have been granted authority to approve, test and deploy their own changes. Access to implement such changes has been limited to very few personnel. However, such changes are not formally reviewed by management to ensure they are consistent with management's intentions.

Recommendation: Changes made to network and operating systems software should be documented. Documentation should evidence testing and approvals of changes made.

Status:

09/30/09 - The Information Systems Division added the IS System Changes control to SOP 2264.14 in January 2009.

12/18/08 - In December 2007, management updated SOP 2264.14, "Network Change Procedures," to clarify the levels of authorization that the Director of Information Systems has granted to TDHCA's Network Administrator, Unix Administrator, and Database Administrator and to establish the Unix, Windows, and Cisco Change Log. The Information Systems Division has been in compliance with the updated version of SOP 2264.14 since that time. By December 31, 2008, management will add an additional control to SOP 2264.14 requiring that employees in these positions email a description of the planned change to a new distribution list named "IS System Changes" prior to initiating certain types of network and operating systems software changes identified in the SOP. The Director of Information Systems will be a member of this distribution list. Email sent to this distribution list will also be posted to a public folder to which all division employees will have read access.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
125	3/3/2009 State Auditor's O	State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ende Federal Portion Audit of the State's basic financial statements and a review of significant	Px	03/03/09 3/31/2009
			Ix	09/30/09

Division: Information Systems

Section: Not Selected

Issue: Condition:

- Genesis – Six users have administrative privileges that allow them the ability to have access to application and database administrator roles and to migrate application code changes into production. In addition, two of these six users are developers. The other four users are user account administrators for Genesis.
- CACS – Two developers have application administrative access rights.
- PeopleSoft – One developer/analyst has database administrator privileges, application administrator rights, and access to migrate code changes into production. TDHCA's Director of Information Systems performs a quarterly review of a PeopleSoft report that includes all changes made to the application. However, the developer/analyst has the ability to alter the report with his high-privilege access rights which are assigned so he can migrate changes into production.
- At the network level, one developer has domain administrative privileges.

Cause: In each system, duties are not appropriately segregated between the application administrators, database administrators, and developers. Also specific developers have access to move changes into the production environment of the individual systems.

Criteria: Community Affairs contract systems for monitoring contracts should allow only the appropriately authorized individuals access to update records.

Effect: Users with inappropriate rights to modify applications create a risk of unauthorized changes to the production environment and/or risks of unintentional errors or omissions in processing.

Recommendation: Duties should be segregated between application administrators, system administrators, database administrators, and developers. In addition, developers who have programming responsibilities should not have access to migrate changes to production. In cases where such condition is necessary, management should implement a monitoring control to help ensure that changes implemented to production are appropriate. Privileged access should only be granted to developers in the test environment. If monitoring controls such as report reviews are put in place, developers should not have access to modify the report.

Status:

09/30/09 - In April and May 2009, the Information Systems Division completed each change to access described in the Corrective Action Plan section of the March 2009 status update.

03/03/09 - Summary of Existing Processes and Monitoring Controls – Because of the size of the Department's Information Systems Division (ISD) and the number of systems supported, management has assigned some ISD employees responsibilities that cross between developer, application administrator, and database administrator roles to provide for efficient delivery of services in the support of production systems and to ensure adequate backup for critical ISD functions. Additionally, in the legacy Genesis system, technology limitations prevent the Department from systematically separating responsibilities between these roles.

Over the past five years, the Department has implemented both manual and systematic processes and monitoring controls for tracking software changes to compensate for the risks posed by advanced levels of systems access. These controls include a series of standard operating procedures governing software, database, and network changes, including a requirement to document approval of direct database updates requested by management within the Department's help desk system; the Software Change Acceptance form; the Object Change Report for PeopleSoft; and the Concurrent Versioning System (CVS), which systematically tracks all software changes promoted to the production environment for the new Community Affairs Contract System (CACS). In addition to these controls, the Department completely segregates developer access between front-end programmatic systems, such as Genesis and CACS, and the Department's general ledger system, PeopleSoft.

Corrective Action Plan – In order to strengthen segregation of duties and further reduce the risk of unauthorized changes to production environments, the Department will remove application administrator access from the two CACS developers and application and database administrator access from the PeopleSoft developer/analyst noted in the finding. While reducing the risks of unauthorized changes, removing these levels of access will pose some production support risks for PeopleSoft, because of limited backup.

Regarding Genesis, the Department will reduce the number of user account administrators from four to two. However, because of the technical limitations mentioned above and because the Department will retire the Genesis version of the Community Affairs Contract System from all but historical inquiry in April 2009, the Department will continue to grant administrative privileges to the two employees who both develop and support remaining Genesis applications, which are administrative in nature. Management will continue to apply manual monitoring controls to the Genesis environment.

Finally, the ISD employee identified as a developer with Windows domain administrative privileges performs no development duties in the Windows environment. The privileges are assigned for backup ISD Network and Technical Support section purposes. Because these privileges provide support benefits to the Department and there is no crossover between developer and administrative responsibilities in this environment, management does not plan to remove these privileges.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
127	8/1/2009 State Auditor's O	A Follow-up Audit Report on Hurricane Recovery Funds Administered by the Department of Following up on prior audit recommendations and covered all matters related to the administr	Px	08/01/09
			Ix	10/15/09

Division: Disaster Recovery

Section: Not Selected

Issue: Chapter 1-A
The Department should continue to work toward addressing delays that have affected the rate at which Community Development Block Grant hurricane recovery funds have been spent.

Status:

- 10/15/09 - The Disaster Recovery Division continues to work proactively with ACS, the COGs, and other parties to streamline program processes where possible to address delays. Since the SAO audit, staff has worked with the contractors and the Board to implement several policy changes or updates to address delays or obstacles to program delivery. The most prominent changes include the implementation of a revised ownership eligibility policy, revised policies to utilize in the event that the required costs to accomplish the approved project exceed allowable program caps for accessibility and/or municipality requirements, changes in the maximum benefit limitation for elevation assistance when such assistance exceeds the established cap, and a revision to our hold harmless agreement regarding notification to lienholders when providing program assistance to an affected property. This has resulted in an increase to 585 homes completed as of November 23, 2009.
- 08/01/09 - Management agrees with the recommendation. However, the streamlining suggested by the SAO must be a coordinated effort among a number of federal, state, and local governmental entities, and significant streamlining may not be possible without changes to federal and state laws governing the Community Development Block Grant program. Disaster response is an urgent need, and where processes can be streamlined or accelerated to bring needed relief more quickly, such improvements will be made. However, they must always be made in a manner that minimizes the risk of fraud, waste, and abuse and provides assurance that these public funds are, in fact, used only to build safe, decent homes for qualified individuals. During the 81st legislative session, the Legislature provided additional guidance to the Department in order to expedite disaster relief even where recipients could not document legal title to their homes. The Department's Governing Board consequently adopted a policy to move forward with providing relief to these individuals. The Department has worked proactively with ACS, the COGs, and other parties to streamline these processes wherever possible and will continue to seek opportunities to address any delays.

Person Responsible: Kelly Crawford

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
128	8/1/2009 State Auditor's O	A Follow-up Audit Report on Hurricane Recovery Funds Administered by the Department of Following up on prior audit recommendations and covered all matters related to the administr	Px	08/01/09
			Ix	11/09/09

Division: Information Systems

Section: Not Selected

Issue: Chapter 1-E

Although the contractor had information technology controls in place for the three information systems tested, auditors identified weaknesses within those controls that should be addressed to ensure compliance with the Texas Administrative Code and the contract between the contractor and the Department. Recommendation: The Department should monitor the information systems of the contractor to ensure compliance with the contractual provisions related to information system controls. Specifically, the Department should:

- Ensure that the contractor assigns unique user IDs to each individual who uses its information systems.
- Ensure that the contractor removes or disables user IDs for its information systems for terminated employees or employees who are not assigned to the Homeowner Assistance Program or the Sabine Pass Restoration Program.
- Ensure that the contractor enables user password expiration and password complexity within the system the contractor uses to manage the application and construction process.
- Ensure that the contractor implements controls that compensate for the password weaknesses in the system the contractor uses to process payments to building contractors.
- Ensure that the contractor documents, tests, and communicates the key components of its information system change control process.
- Ensure that the contractor stores backup data off site.

Status:

- 11/09/09 - The Department's Information Systems Division management and IT security staff have met with ACS to follow up on the status of each recommendation from chapter 1-E of SAO report 09-048. ACS provided the Department with a description of how each recommendation was addressed and with its written IT change control policies. On an ongoing basis, the Department will conduct monitoring visits to review ACS IT security and disaster recovery controls and procedures.
- 08/01/09 - Management agrees with the recommendation and will work with ACS to ensure that their information technology controls are strengthened. TDHCA's Information Technology staff and Disaster Recovery & Emergency Housing staff will meet with ACS and ensure that the necessary measures are taken and that the recommended controls are implemented.

Person Responsible: Curtis Howe

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
150	8/25/2010 Internal Audit	An Internal Audit of Accounting Operations Financial transactions processed by accounting operations between September 1, 2007 and	Px	08/25/10 9/10/2010
			Ix	10/22/10

Division: Financial Administration

Section: Accounting Operations

Issue: Of the 288 transactions tested, one HOME transaction did not have supporting documentation showing that the appropriate supervisory approval occurred and one HTF transaction did not have supporting documentation identifying the preparer. In addition, we noted that budget and expenditure transfers that affect the divisions did not have any supporting documentation showing the transfer was originally authorized by the division affected by the transfer.

Because Accounting Operations relies on supporting documentation as evidence of the validity of financial transactions, in addition to what is reflected in PeopleSoft, it is important that the supporting documentation include the appropriate authorizations and supervisory approvals. It is also important to maintain all supporting documentation necessary to these transactions. This will ensure that Accounting Operations is conducting transfers in accordance with the directions of division management.

Recommendation:

When Accounting Operations is processing budget and expenditure transfers, they should maintain the authorization from the originating division.

Status:

- 10/22/10 - As of September 10, 2010 the Manager of Accounting Operations has ensured that all supporting documentation is initialed by preparers and approvers. The Manager is also ensuring that all supporting documentation for budget and expenditure transfers are maintained.
- 08/25/10 - Financial Administration will ensure the authorization from the originating division is maintained when budget or expenditure transfers are processed. We will also ensure all supporting documentation is initialed by preparers and approvers. This process will be implemented by September 10, 2010 and is the responsibility of the Manager of Accounting Operations.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
151	8/25/2010 Internal Audit	An Internal Audit of Accounting Operations Financial transactions processed by accounting operations between September 1, 2007 and	Px	08/25/10 9/10/2010
			Ix	10/22/10

Division: Financial Administration

Section: Accounting Operations

Issue: There is no supervisory review of the contract award set-ups in PeopleSoft. Once the contract award has been set-up in PeopleSoft, the grant accountants have the ability to begin entering draw downs against the contract. In addition, of the 90 contract awards tested, 34 (37.8%) had at least one amendment that either increased or decreased the contract award. A supervisor does not review these changes to the award amount. Because there is no supervisory review of the contract award set-ups or of contract award amendments, there is a risk that the grant accountants who process draw downs could believe that there are more or less funds available than there actually are. In addition, the risk increases if the contract award amount is amended.

Recommendation:

Accounting Operations can strengthen their federal draw process by implementing a review step for the contract award set-ups and contract award amendments in PeopleSoft to ensure the contract award amounts are set-up accurately and that contract award amendments are entered correctly.

Status:

- 10/22/10 - As of September 10, 2010 the Manager of Accounting Operations has expanded their contract review process. All subrecipients contracts are reviewed by team leaders or senior accountants to ensure that contract amounts are set-up accurately and that award amendments are entered correctly.
- 08/25/10 - Accounting Operations will expand our contract review process. All subrecipient contracts will be reviewed by the team leader or senior accountant to ensure accuracy. Supporting documents for contract setup and amendments will be approved and maintained. We will also work with Information Systems to explore automation of this process. This will be implemented by September 10, 2010 and is the responsibility of the Manager of Accounting Operations.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
152	8/31/2010 Internal Audit	An Internal Audit of the Construction Quality in the Disaster Recovery Division CDBG Disaster Recovery Round Two funds and completed home files as of June 8, 2010.	Px	08/31/10 9/30/2010
			Px	10/25/10
			Ix	01/10/11

Division: Disaster Recovery

Section:

Issue: ACS delegated the management of the construction of disaster recovery homes to its subcontractor, Shaw. ACS does not provide sufficient active, ongoing oversight of Shaw's management of the construction process as required by ACS's contract with the Department. The contract between ACS and the Department requires ACS to conduct reviews, perform testing and develop processes to assure quality performance and timeliness of suppliers. In addition, the contract requires ACS to provide written results of its quality assurance processes. We tested a random statistical sample of 100 completed homes and found that eighty-six of 100 (86.0%) completed home files did not contain documentation of a workmanship inspection.

ACS has performed some limited oversight of construction. They hired a third party inspector to conduct workmanship reviews between June 2009 and early February 2010. Ten of the 14 files (71.4%) found to have a workmanship inspection contained a single photograph of the exterior of the home or a photo of an empty lot as evidence of the inspection. Subsequently, ACS hired a construction manager to conduct inspections of the construction sites. The construction manager does not use a checklist nor does he file a report for these site visits. Without documentation of these visits, there is no record to support any assistance or guidance provided to the builders.

The ACS production manager provides some operational oversight of the construction process. The production manager conducts a daily conference call to discuss anticipated application approvals, anticipated and actual closings, anticipated and actual construction starts, inspections and completed homes. The purpose of this daily call is to share data with the Department and with Shaw. However, the data in these reports may not be accurate because some of this data consists of forecasts and estimates. In addition, the data is not aged beyond 30 days, and includes data self-reported by the builders which could be manipulated.

The ACS construction manager and production manager are responsible for overseeing Shaw, as well as the home inspectors and the home builders. However, ACS has not provided specific guidance nor current written procedures to these oversight staff. Without guidance or updated procedures, these staff may not be aware of all of their responsibilities.

Recommendations

- The Department should ensure that ACS provides active and ongoing oversight of the construction management function.
- The results of ACS's oversight should be documented, reviewed and retained by the Department to ensure that it is performed properly.
- ACS should establish a procedure to provide written feedback to Shaw and their building contractors when needed.
- ACS should develop and implement a formal policy and current written procedures for providing oversight of the construction management function.

Status:

- 01/10/11 - Management provided guidance to ACS regarding ongoing oversight of the construction management process. ACS achieves this through multiple status update conferences with Shaw as well as tracking production through the pipeline. The Department enhances ACS' activities by performing onsite construction inspections on a regular basis and will continue this practice through the end of the contract. A follow up review indicates that this risk is mitigated adequately by these activities.
- 10/25/10 - Management provided guidance to ACS regarding ongoing oversight of the construction management process. ACS achieves this through multiple status update conferences with Shaw as well as tracking production through the pipeline. The Department enhances ACS' activities by performing onsite construction inspections on a regular basis and will continue this practice through the end of the contract. Due to the fast approaching end of the contract, no further action will be implemented.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
08/31/10 -	Management acknowledges the need for ongoing oversight of the construction management function and will provide guidance to ACS on ways to enhance their documentation of oversight they are currently conducting as well as feedback provided to Shaw and the building contractors. Management will also include this in the design of programs moving forward to require the inspections in large scale disaster recovery programs, and also require the physical documentation that the work has been done in a timely manner.			
	Implementation Date: September, 2010			
	Staff Responsible: Disaster Recovery Director and Grant Compliance Manager			
153	8/31/2010 Internal Audit	An Internal Audit of the Construction Quality in the Disaster Recovery Division CDBG Disaster Recovery Round Two funds and completed home files as of June 8, 2010.	Px	08/31/10 9/30/2010
			Ix	10/25/10

Division: Disaster Recovery

Section:

Issue: We tested a random statistical sample of 100 completed home files to determine whether the files contained sufficient documentation to support the inspection and approval processes. We found that nineteen of 100 files (19.0%) did not contain the required inspection documentation. For example:

- One of two (50.0%) of the rehabilitation inspections included in the sample did not contain any documentation of the completed work.
- Four of 26 (15.4%) manufactured home files did not contain the required T-Form, which is an installation inspection application filed with the Department's Manufactured Housing Division to verify that the manufactured home is installed properly.
- Nine of the 100 files (9.0%) with approved final inspections contained notes in the file or on the Housing Quality Survey form that appliances were missing from the home. Six of these were due to theft and in three of these homes the appliances were not delivered before the final inspection.
- One home did not have evidence of working electrical service.
- Five files did not have signed final inspection documents. These documents should be collected by the inspector during the final inspection

Although checklists are used to ensure that all of the required documentation is completed, final inspections are accepted even when the paperwork is not complete. The builder can request the balance of the payment for the home (less a 10% retainage) when the final inspection is accepted. (See Appendix C for more information regarding the inspection process.) If the inspection requirements are not met but the bulk of the funds are paid out, this could put the Department at risk if the home is not satisfactorily completed.

Recommendations

ACS should ensure that:

- all inspection requirements are completed and documented in the file prior to accepting the final inspection, and
- all required documents are present in the file before paying the builders.

Status:

10/25/10 - ACS conducts a quality assurance control which includes ensuring that inspection reports are uploaded in the Worltrac system and available prior to paying builders. This concern is further mitigated by the independent random inspections performed by the Department to ensure that homes are complete and compliant to ensure funds are being expended appropriately.

08/31/10 - Management will work with ACS to ensure that all requirements are met and all documentation exists to support a proper final inspection that substantiates completion and payment to the builders.

Implementation Date: September 2010

Staff Responsible: Disaster Recovery Director and Grant Compliance Manager

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
154	8/31/2010 Internal Audit	An Internal Audit of the Construction Quality in the Disaster Recovery Division CDBG Disaster Recovery Round Two funds and completed home files as of June 8, 2010.	Px	08/31/10 9/30/2010

Division: Disaster Recovery

Section:

Issue: ACS tracks the number of construction complaints (tasks.) Complaints are aged to determine how long they are outstanding. Currently the complaints are aged in 3 to 15 day increments up to 30 days. All complaints over 30 days are classified as 30+ days which is the highest range for classification. The production report that shows the classification of complaints is referred to as the dashboard report. As of the July 11, 2010 dashboard report, 66.0% of the construction-related complaints were more than 30 days old. This suggests that tasks are not resolved in a timely manner and that management may not be aware of the true age of a complaint once it exceeds 30 days.

Tasks can be marked as completed by the builder even when they are not completely resolved. For example, a builder scheduled the work to complete the task and at that point changed the task status to completed, although the work to satisfy the complaint was not yet accomplished. Because the task status was changed to completed, it appeared that the homeowner's issue was completely resolved, and that the resolution occurred at an earlier point in time.

Recommendations

ACS should:

- ensure customer complaints are resolved in a timely manner,
- monitor the construction-related tasks regularly to ensure that a task is completely resolved before it is marked as complete by the builder,
- consider expanding the range for classifying outstanding construction complaints to include: 31-60 days, 61-90 days, 91-120 days and greater than 120 days,
- consider evaluating customer satisfaction by using telephone calls, letters and surveys to help identify and resolve the causes of homeowner dissatisfaction.

Status:

- 01/10/11 - ACS' call center continues to receive and log applicant complaints into the WorlTrac system. Applicants are also encouraged to contact their builder since the warranty is provided by the builder. A complaint system was not required by the scope of work; however, the contractor provided a system to receive, log and track homeowner complaints. These complaints continue to be received, tracked and resolved; many times DR staff are involved and follow complaints to resolution. The Department also deploys independent inspection personnel to resolve serious complaints and follow up on those complaints to ensure resolution. These actions appear to adequately mitigate this issue.
- 10/25/10 - ACS' call center continues to receive and log applicant complaints into the WorlTrac system. Applicants are also encouraged to contact their builder since the warranty is provided by the builder. ACS is developing a Construction Complaint system to ensure complaints are addressed in a timely manner. The Department will continue to monitor this issue throughout the contract period.
- 08/31/10 - Management will work with ACS to more closely manage the complaint process. The process for resolving complaints will not end when the contract does as one of the key goals for this program is to create a relationship between the homeowner and the builder so the property homeowners could require in traditional methods warranty work be done. For the duration of this Program, and to provide the most information as the program closes, correction of complaints should be completed immediately. Since the Program will be concluding within the next four months, management will carry forward this process improvement recommendation as a best practice for future disaster recovery programs.

Implementation Date: September 2010 and ongoing

Staff Responsible: Disaster Recovery Director and Grant Compliance Manager

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
155	8/31/2010 Internal Audit	An Internal Audit of the Construction Quality in the Disaster Recovery Division CDBG Disaster Recovery Round Two funds and completed home files as of June 8, 2010.	Px	08/31/10 9/30/2010

Division: Disaster Recovery

Section:

Issue: ACS has contractually delegated the responsibility for the repair of existing homes to its subcontractor Shaw. Shaw is currently the general contractor for the rehabilitation portion of the disaster recovery program.

The contract between ACS and Shaw allows Shaw to engage in both contracting and inspection activities. As a result, Shaw is inspecting its own construction work. This lack of segregation of duties increases the possibility of errors and increases the risk that fraud or mismanagement could occur.

The Shaw manager reviews and accepts bids from subcontractors for rehabilitation work. The manager is also responsible for assigning the Shaw inspectors to inspect the rehabilitation work performed by its own subcontractors. In addition, the manager reviews and approves the inspection documents and photos entered into the WorlTrac system. When the builder submits a request for payment, the request is approved by the Shaw manager. The purpose of segregating duties is so that the same individual is not in a position to initiate, approve, and review the same activity.

Recommendation

ACS should ensure that Shaw segregates duties among its employees so that the same employee is not assigning contractors and inspectors, reviewing and approving inspection documents and authorizing payments.

Status:

- 04/19/11 - Disaster Recovery staff previously conducted an onsite monitoring review to evaluate documentation for construction inspection oversight. Staff found that ACS' quality control process did not consistently ensure that all inspection support documents were uploaded into the WorlTrac system to support payment of work conducted for rehabilitation. Therefore, the Department advised ACS to implement further oversight of Shaw's process. ACS has implemented additional oversight, and the Division has evaluated these actions and finds them satisfactory.
- 01/10/11 - TDHCA staff conducted an onsite monitoring review to evaluate documentation for construction inspection oversight and documentation. Staff found that ACS' quality control process does not consistently ensure that all inspection support documents are uploaded into the WorlTrac system to support payment of work conducted for rehabilitation.
- 10/25/10 - ACS has reviewed this process and determined that there exists adequate separation of duties within Shaw's management team regarding the assignment and review of contractors and inspections as well as authorization of contractor draws. Also, ACS provides a separate control by their review, final authorization, and payment of these activities.
- 08/31/10 - While there are very few rehabilitations left to undergo this process, management will work with ACS to determine if any further segregation of duties can be attained and will work to ensure enhanced oversight of this process.

Implementation Date: September 2010

Staff Responsible: Disaster Recovery Director and Grant Compliance Manager

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
157	11/15/2010 Internal Audit	An Internal Audit of Information Technology Governance To determine if the Department's leadership, organizational structures and processes ensure	Px	11/15/10

Division: Information Systems

Section:

Px 11/15/10
Px 01/07/11 1/26/2011
Px 04/06/11

Issue: The policies and procedures used by IS to handle requests for new systems or for system changes may need revision. The current policy (SOP 1264.08) classifies IS requests into eight different categories and identifies the process for requesting the IS service. In addition, the policy states that any IS request that is estimated to take 16 hours or more to complete requires the completion of the Change Request Form and any IS request that is estimated to take 200 hours or more to complete requires the completion of the IS Project Request Form. These forms are then presented to the IS Steering Committee for approval. However, IS does not consistently follow this policy as it relates to the Change Request Form and the IS Project Request Form. There is a risk that these requests may not be consistently tracked or appropriately prioritized without the use of a formal documented process to consistently handle these requests.

Recommendation

IS should consistently follow the policy 1264.08 - Requesting IS Services as stated or update the policy to reflect the current process.

Status:

- 04/06/11 - At the February 16, 2011 IS Steering Committee (ISSC) meeting, revisions to SOP 1264.08 to change the required ISSC approval threshold for IS projects to 50 hours (up from 16 hours). The revisions were approved by the committee and routed for Department approval in early March. However, ISD is already following the updated version of the SOP, since it was approved by the IS Steering Committee. The entire IS Division was made aware of the procedure change via email. Once the revised SOP has been approved by the Department, the issue will be reported as implemented.
- 01/07/11 - IS Steering Committee review of SOP 1264.08 is an agenda item for the January 26, 2011 meeting. Management will adopt any changes approved by the committee at the meeting and will resume consistent use of the Change Request Form and IS Project Request Form.
- 11/15/10 - In conjunction with the renewal of IS Steering Committee meetings, management will resume consistent use of the Change Request Form and IS Project Request Form as defined in SOP 1264.08.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
160	2/22/2010 KPMG	State of Texas Federal Portion of the Statewide Single Audit Report For the Fiscal Year End Federal Portion Audit of the State's basic financial statements and a review of significant con	ix	02/22/10 1/31/2010

Division: Disaster Recovery

Section:

Issue: The requirements for submission of a Performance Evaluation (PER) pursuant to 42.U.S.C. 12708 and 24 CFR 91.520 are waived for Community Development Block Grant (CDBG) Disaster Recovery Grantees Under 2008 CDBG Appropriations. However, the alternative requirement is that each grantee must submit a quarterly performance report, as HUD prescribes, no later than 30 days following each calendar quarter, beginning after the first full calendar quarter after grant award and continuing until all funds have been expended and all expenditures reported. Each quarterly report will include information about the uses of funds during the applicable quarter including (but not limited to) the project name, activity, location, and national objective; funds budgeted, obligated, drawn down, and expended; the funding source and total amount of any non- CDBG disaster funds; beginning and ending dates of activities; and performance measures such as numbers of low and moderate-income persons or households benefiting. Quarterly report to HUD must be submitted using HUD's Internet based DRGR system and, within 3 days of submission, be posted on the grantee's official Internet site open to the public. (February 13, 2009 Federal Register Vol. 74, No. 29, page 7252)

The performance reports for quarters ending December 31, 2008, March 31, 2009, June 30, 2009, and September 30, 2009, were not posted to Texas Department of Housing and Community Affairs' (TDHCA) Website. Since notification, management of TDHCA has posted the above noted performance reports to their Website.

Recommendation:
TDHCA should ensure that someone is responsible for the posting of the above noted performance reports on a timely basis.

Status:

02/22/10 - Controls have been established to ensure posting of the DRGR reports to TDHCA's Website no later than three days after the report has been submitted to HUD via their internet based DRGR system.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
161	2/22/2010 KPMG	State of Texas Federal Portion of the Statewide Single Audit Report For the Fiscal Year End Federal Portion Audit of the State's basic financial statements and a review of significant con	ix	02/22/10 2/28/2010

Division: Information Systems

Section:

Issue: Access to migrate code changes into production as well as system administrator privileges should be restricted appropriately based on job function to help ensure adequate internal controls are in place and segregation of duties exist. Access to deploy and develop code changes should be segregated. Similarly, system administrative access should also be restricted to non-developers. Texas Department of Housing and Community Affairs (TDHCA) outsource both WorlTrac and Portfolio maintenance and operations to multiple third-party providers. Portfolio's primary function is applicant eligibility while WorlTrac is the primary source of the financial transactions. During the performance of general controls test work for the WorlTrac and Portfolio applications, the following items were noted:

- A) Three developers have access to the administrative server-level IDs for the Portfolio application server, while one developer also has direct administrative access on the application server. These three developers also have DBA rights on the production database server. Overall, the three developers could also deploy code changes into production. In addition, there is no policy restricting the use of generic IDs. Generic IDs are in use by the above developers that allows them access to administrative functions on the servers. Additionally, user access reviews as it relates to Portfolio are not defined and/or performed periodically. If performed, evidence of access review is not retained.
- B) Of 25 Portfolio changes selected, 4 exceptions were noted in that evidence of authorization. Testing and approval were not consistently retained and in one case, approvals were obtained after code was deployed into production.
- C) Access to the disbursement file is open to all ACS Domain users as it is placed on a shared drive. Access should be restricted only to the disbursements team and the ACS Finance team.
- D) Three application developers have access to migrate WorlTrac code changes into production and were intentionally assigned this access as part of their daily job functions; however, no additional monitoring control was put in place to mitigate the associated risk. Also, three developers were noted to have administrative access on the WorlTrac application and one developer has administrative access on the production database.
- E) For 40 selected WorlTrac changes, no end-user testing had been performed prior to deployment. As a policy, QA testing of WorlTrac changes is not performed by the end user prior to deployment, unless specifically requested. Also, 13 of 40 WorlTrac changes did not contain any approval before or after deployment into production. In addition, the generic ID with DBA privileges on the WorlTrac database is accessed by two System Administrators, and one Developer.
- F) No policy document exists to define user access review requirements for the WorlTrac application. Also, no user access privileges review was performed for the WorlTrac application during the audit period. Further, a password policy was not adequately defined for the WorlTrac application. Its underlying systems did not have password requirements defined. Lastly, no Information Security Policies and Procedures exist for the WorlTrac application specific to the Texas HAP/SPRP project.

Developers were granted access to production to assist in troubleshooting, end user support, and application changes. However, developer access to administrative functions on any production system results in the risk of unauthorized changes to applications and data. Additionally, developer access to move their code changes into production increases the risk that unauthorized changes to application functionality have been deployed into the production environment.

During the performance of application controls test work for the WorlTrac and Portfolio applications, the following items were noted:

- G) During review of disbursements to contractors, 14 of 40 disbursement files did not contain all the required documentation to support the expenditures. Each of the 14 files had some of the required documentation. This function is performed by the primary contractor. (24 CFR Section 570.482)
- H) With regard to the environmental inspection process, 1 of 40 files reviewed did not contain the required environmental inspection and environmental clearance documents. Environmental files are maintained in WorlTrac (24 CFR Section 58.4(b)(1), 58.34, and 58.35).

Recommendation:

Management should implement robust information technology general controls over all key applications and underlying systems. Information technology general controls should be in place to restrict high-privileged access to applications, servers and databases, enforce generic ID policies, periodic access review controls, and strong change management controls including authorization, testing and final approval of changes. Developer access to administrative functions on any production system results in the risk of unauthorized changes to applications

and data. Additionally, developer access to move their code changes into production increases the risk that unauthorized changes to application functionality have been deployed into the production environment. Developer access to production should also be segregated. Further management should remove system administrative privileges granted to the developers. TDHCA should monitor their contractors to ensure compliance with the program's policies and procedures as to processing transactions and maintaining documentation.

Status:

02/22/10 - TDHCA agrees with the finding and is committed to effecting corrective actions. TDHCA has been in consultation with the vendor, ACS, on enhancing IT controls in place and defining and implementing additional IT controls to address the issues in this finding. The IT controls and implementation dates are detailed below. TDHCA, ACS, and two subcontractors, Reznick and Worley Company, will be involved in these corrective actions. TDHCA has been monitoring IT controls for Portfolio and WorlTrac since October 2009 and will increase the level of monitoring for the remainder of the contract.

Detailed Responses for Each Audit Issue:

A) Developers no longer have administrative or DBA access to production servers and data and can no longer deploy code changes into production. To ensure the proper separation of duties, effective January 30, 2010, an individual different from the developers is required for production deployment. As of February 1, 2010, database mirroring was implemented for Portfolio, which causes a copy of the live database to be in a separate instance. This allows the developers to have full control over a snapshot of the live data without accessing the production environment, so they can complete reporting, troubleshooting, and other requirements. Developers are now limited to read-only access to the production data.

Generic IDs are required for the execution of services and scripts and are utilized to connect applications to databases securely. Administrators cannot utilize their own usernames because it will give the false impression that an administrator has executed the script, service, or application in question. As of January 30, 2010, all generic IDs have lost their administrative level access, except for the account 'aisrunner' which is currently required for the operation of Portfolio. Ways to limit this account's access are being tested with a planned implementation date of February 28, 2010. In addition, a Generic ID policy was created that restricts the account knowledge, management, and administration to the senior systems administrator and the Reznick IT manager and implements separation of duties by requiring any use or management of these IDs to be documented and approved in writing.

At the time of the audit, the Reznick Information of Technology was not recording regular user account audits due to the size of the entity. Reznick recognizes that documentation should have been gathered and stored for review purposes of regularly scheduled account audits, so regularly scheduled account audits will be conducted from this point forward.

B) Regarding obtaining evidence of testing and approval, this process follows a documented change policy. The Reznick IT manager must approve changes before designated employees can deploy code to production. In two of the four cases noted, a hard drive crash erased the e-mails that documented the authorization, testing and approval prior to January 2009, and the evidence for those cases was unavailable. In another case, changes were approved prior to deployment, but were not tested. The deployment contained other items that had been tested. The item in question was tested the morning after deployment, in compliance with the standard practice to review all deployments immediately after they are released in the production environment. For the remainder of the Texas Homeowner Assistance Program/Sabine Pass Restoration Program (HAP/SPRP) contract, IT management will ensure that testing and approval actions for code changes are performed and documented prior to deployment to production.

C) As of December 2, 2009, the Solomon financial system folder that contains the disbursement files has been restricted to individuals requiring access to perform their required job functions. As a mitigating control prior to the time of this change, an individual would also have required access to the Solomon financial system in order to import a disbursement file. In addition, the disbursement files are write-protected. The ACS Finance team reviews all disbursement files to ensure the proper payment amount and payee prior to their import into Solomon.

D) Administrator access and access to migrate code change were removed from developers on January 30, 2010.

E) Only modifications or additions requested by ACS in writing are considered by Worley. Effective January 30, 2009, user acceptance testing (UAT) and approval is performed and documented before promoting WorlTrac changes into production. Worley will enforce the TDHCA password policy for the generic ID used by the Database Administrator (DBA). Use of this ID and knowledge of this password will be limited to the WorlTrac DBA and Worley Project Manager.

F) Every effort is made to ensure that access to the WorlTrac system is kept current for all individuals that require such access. When an

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
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employee separates from the program, notification is sent to the Call Center Manager who then submits a Mantis ticket to have the individual's access deactivated immediately. Confirmation of this deactivation is sent through the Mantis ticket response. Effective February 1, 2010, a monthly review process of all active user accounts is performed by extracting a report of all active users from WorlTrac by company. A list of all active users is e-mailed to a designated member of management from each company to review their subset of the report and identify any errors. Confirmation that verification of report has been completed is returned by e-mail. Any problems are immediately addressed. Worley will document its IT security policies and procedures for WorlTrac specific to the Texas HAP/SPRP project by February 28, 2010. The written policies will include WorlTrac password requirements for all WorlTrac accounts. The password requirements will be enforced on the WorlTrac server.

G) We agree that at the time of the draw request, 14 of the 40 Disbursement files did not contain all the required documentation to support the draw. Prior to the last day the auditor was on site, documentation had been received in 11 of the 14 cases. Subsequently, the documentation was received for the three remaining cases. While the process to verify the draw documentation was not consistently followed, there exist a number of other controls to ensure funds are not disbursed to the wrong contractors. These controls are both system enforced (for example, an accepted inspection work order must be complete in WorlTrac before any disbursement can be made) and manual (for example, the contractors to whom payments are made are set up in Solomon by an individual completely outside the draw process). Since October 5, 2009, no payments have been released to any contractor without the proper documents having been verified by ACS staff.

H) The environmental inspection process consists of two components, an on-site inspection and the completion of a Site Specific Check List (SSCL). With respect to the application identified in this audit finding, the on-site environmental inspection was performed on December 29, 2008, in conjunction with the program initial inspection. The SSCL was, however, not submitted to TDHCA for approval. On October 7, 2009, ACS identified that the environmental work order was accepted without approval from TDHCA and took immediate measures to prevent this from occurring again. In November 2009, system modifications were implemented, which do not allow the claim state of Environmental Work Orders to be changed to "Accepted" without an approved SSCL.

162	<u>7/20/2010</u> HUD-OIG	<u>Community Development Block Grant (CDBG) Supplemental II Disaster Recovery Report #2</u> To determine whether TDHCA followed Federal and State of Texas regulations in procuring t
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<u>Status</u>	<u>Target Date</u>
Px	07/20/10
Nx	04/19/11

Division: Disaster Recovery

Section:

Issue: TDHCA did not always follow Federal and State requirements and best practice procedures in the evaluation of the single proposal and subsequent award of the contract to the Firm.

Recommendation 1A:

We recommend that HUD's Disaster Recovery Assistance and Special Issues Division require TDHCA to adopt sound agency business procedures for Disaster Recovery-funded procurements in accordance with State policy.

Status:

- 04/19/11 - Management evaluated the procurement process and determined the process to be sound as written to ensure proper procurement controls and education. The procurement process will not be altered.
- 07/20/10 - TDHCA has a very long history of complying with state procurement policies in the many reviews we have with state reviewers and discussions with the agencies directing the contracting process. Even with the excellent working relationships with external departments in our procurement process, we do believe that we can clarify the process and will review and either alter as necessary an internal Standard Operating Procedure for procurement (SOP 1210.03) or draft a specific SOP to reflect processes for procurements that involve limited bidders.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
163	7/20/2010 HUD-OIG	Community Development Block Grant (CDBG) Supplemental II Disaster Recovery Report #2 To determine whether TDHCA followed Federal and State of Texas regulations in procuring t	Px	07/20/10
			Ix	04/19/11

Division: Disaster Recovery

Section:

Issue: TDHCA accepted a proposal that materially did not meet specifications and made material changes to the request's specifications during contract negotiations.

Recommendation 1B:

We recommend that HUD's Disaster Recovery Assistance and Special Issues Division require TDHCA to train staff to adequately follow State and Federal procurement requirements in the evaluation and acceptance of proposals and contract negotiations and contract formation. Further, if staff fail to follow requirements, TDHCA should have procedures in place to address noncompliance.

Status:

- 04/19/11 - Staff who handle procurement processes receive ongoing training as required by the State of Texas. Documentation was submitted to HUD to illustrate procurement staff training that ensures proper procurement controls and education.
- 07/20/10 - TDHCA took several steps to ensure a quality procurement in this contract process recognizing the difficulty that could be ahead. TDHCA hired the nationally respected law firm of Vinson and Elkins to work with the drafting of a comprehensive and complete Request for Proposals. TDHCA worked with the Texas Comptroller's Office to meet the state standards and to have additional procurement expertise provide guidance on the process. TDHCA acknowledges that additional training as part of the development of the new or revised SOP discussed in Recommendation 1A, will be needed and TDHCA commits to that training.

The recommendation also references the contract negotiation process. After the award process, TDHCA received approval by the Office of the Attorney General to employ the nationally respected government contract outsourcing legal firm of Hunton & Williams for the development of the Master Services Agreement (MSA). TDHCA is in agreement that one key exhibit to the contract will need to be addressed in relation to Recommendations 1D, 1E, and 1F to provide greater clarity. That particular exhibit included a comprehensive program development and budget which attempted to forecast a new and previously unknown method of delivery of disaster recovery services.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
164	7/20/2010 HUD-OIG	Community Development Block Grant (CDBG) Supplemental II Disaster Recovery Report #2 To determine whether TDHCA followed Federal and State of Texas regulations in procuring t		

Division: Disaster Recovery

Px 07/20/10

Section:

Ix 12/20/10

Issue: TDHCA made material changes to the contract that budgeted \$210,000 for proposal preparation costs prohibited by Federal regulations

Recommendation 1C:

We recommend that HUD's Disaster Recovery Assistance and Special Issues Division require TDHCA to reimburse the HUD funded Disaster Recovery program \$210,000 for any ineligible proposal preparation costs.

Status:

- 12/20/10 - The Department issued a letter on October 26, 2010 wherein \$210,000 was recaptured from our program management firm, ACS, from an administrative draw request, for ineligible proposal preparation costs identified in the report. Allowable pre-award costs are limited to the contract negotiation period, which is between the date the TDHCA Board approved negotiations with ACS (August 23, 2007) and the date prior to the contract execution date (12/31/2007). Under the Master Services Agreement, ACS may dispute a recapture or resubmit eligible expenses. At this time, neither a dispute nor submission for eligible expenses has been received by the Department.
- 07/20/10 - It is important to note that TDHCA's limitations in the Request for Proposals to eliminate the use of taxpayer funds for development costs for submissions seeking this business is the basis for this recommendation. Sufficient documentation existed to justify the reimbursement of these expenses, but in drafting the RFP TDHCA did not believe that taxpayers should pay for the costs of private businesses to seek state contracts and did not allow RFP response costs. Unfortunately, there was an error made in allowing this type of expense to be paid in conflict with the RFP. TDHCA agrees with this finding and will recapture \$210,000 in disallowed costs from the contractor and return it to the program for eligible costs.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
165	7/20/2010 HUD-OIG	Community Development Block Grant (CDBG) Supplemental II Disaster Recovery Report #2 To determine whether TDHCA followed Federal and State of Texas regulations in procuring t	Px	07/20/10 8/15/2010
Division: Disaster Recovery			Ix	12/20/10

Section:

Issue: TDHCA made material changes to the contract that increased the maximum cost by \$1,994,841 million and contracted to pay the Firm using multiple payment types including \$2,231,365 million for a cost plus a percentage of cost type, which is prohibited by Federal regulations. In addition, TDHCA's contract with the Firm lacked sufficient detail tying construction management services and oversight to the payment and budget section costs for the proper identification and allocation of \$14.33 million in costs: \$10,048,676 in estimated "per Home Rate" costs, \$2,856,620 for budgeted "Construction Management," and \$1,422,128 for "PMO-Shaw Labor" Costs.

Recommendations

We recommend that HUD's Disaster Recovery Assistance and Special Issues Division require TDHCA to:

- 1D. - Provide support for the \$1,994,841 material increase to the administrative fees or repay its HUD funded Disaster Recovery program.
- 1E. - Modify its contract to correct the \$2,231,365 cost plus a percentage of cost "Construction Mgmt Fee." Any payments made to the Firm under this payment type must be repaid to its HUD funded Disaster Recovery program.
- 1F. - Modify the contract language to include sufficient detail to allow for the proper tying of budgeted costs to the scope of services and approve a final budget that properly identifies and allocates all costs to support \$14,327,124 in questioned costs: \$10,048,376 in estimated "Per Home Rate" costs, \$2,856,620 for budgeted "Construction Mgmt," and \$1,422,128 for "PMO-Shaw Labor" costs.

Status:

- 12/20/10 - It is important to note that all funds expended to date have gone to develop more than 2,350 homes in the Hurricane Rita impacted areas - at this point the largest housing recovery effort in Texas history. The Department has verified that even with all the houses already completed, no funds referred to in Recommendation 1D were spent, and therefore no recapture was necessary. The Department agrees in general that modification of the contract type and Exhibit 4.1, which includes the budget and general structure of reimbursements, would increase clarity. The Department has negotiated and executed an amendment with our contractor to more accurately reflect services as they are currently being provided based on our operations. The contract amendment was executed December 7, 2010. The original contract has been modified to address the cost increase from the FRP, and to comply with HUD regulations. We feel these actions address the concerns raised related to clarity, type of payment and mischaracterization of administrative payments above the RFP amount.

07/20/10 - TDHCA has combined Recommendation 1D, 1E, and 1F because of the similar treatment in addressing the recommendations. TDHCA believes that it is important to note that all funds expended to date have gone to develop more than 1600 homes in the Hurricane Rita impacted areas - at this point the largest housing recovery effort in Texas history. In addition, the method of delivery using the outsource mechanism has drawn support at congressional hearings from public advocates (including at two different congressional hearings) as being "...in many respects [is] superior to our initial idea. Given the difficulty of hiring contractors, ensuring the quality of their work and holding them accountable, it is better to have the State overseeing the contracting rather than to place the responsibility on elderly or low income homeowners." Texas' desire to provide safe, decent and affordable housing rather than a compensation program has taken time and placed many unknowns in the process. In fact, the concern identified about the difficulty with contractors has been borne out to be true given the challenge of finding qualified contractors that slow program progress. TDHCA wishes the entire process could have gone more quickly, but there are several hurdles that do slow down the process, including the time to procure and contract with needed resources to rebuild communities.

The Department has verified that even with all the houses we have already completed, no funds referred to in Recommendation 1D have been spent and therefore no recapture will be necessary for any previously expended funds. Our preliminary testing of existing files also allows us to be confident that there is adequate support for the funds referenced in Recommendation 1F so that no repayment would be anticipated due to an inability to tie expenditures to eligible activities.

Even though progress is being made more quickly now and TDHCA is satisfied based on our experience that proper cost controls are in place, TDHCA agrees in general that we should modify Exhibit 4.1 which includes the budget and the general structure of reimbursements to increase clarity. TDHCA has begun discussions and negotiations with our contractor to amend the contract by redrafting Exhibit 4.1 including a new budget, based on our current operations. During this amendment process, we will also address the cost increase of the original contract over the amount stated in the RFP and modify the contract to be generally compliant with the HUD OIG recommendations. At the end of the day, we expect amended Exhibit 4.1 and any other amendments to address the concerns raised within this finding related to clarity, type of payment, and mischaracterization of administrative payments above the RFP amount. We expect this amendment to be completed not later than August 15, 2010.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
166	8/13/2010 HUD	HOME Federal Labor Standards Monitoring Review June 8-10, 2010 On-site review of TDHCA's federal labor standards administration and enforcement under ap	ix	04/21/11

Division: Program Services

Section:

Issue: Criteria: The review team found significant weaknesses and deficiencies within TDHCA's monitoring procedures, documentation, and follow-up. These deficiencies affect the agency's ability to ensure compliance with prevailing wage requirements of the Davis-Bacon and Related Acts, including the requirements set forth in HUD Handbook 1344.1 REV.1 CHG1, Federal Labor Standards Compliance in Housing and Community Development Programs, and in 29 CFR Subpart 5.5 and other relevant regulatory requirements of Title 29, as well as, Sec. 286 of the National Affordable Housing Act (NAHA).

Condition: TDHCA's monitoring policy documents, forms, the monitoring "Testing Tool" spreadsheet, correspondences, monitoring reports were reviewed and interviews with staff was conducted. TDHCA has established a monitoring methodology. The Office of Labor Relations appreciate the State's efforts to create a system consistent in its use and application, but find TDHCA's efforts do not consistently monitor for essential and required aspects for labor standards compliance. Examples are lack of documentation in project files; contractor's eligibility not in contract documents folders, employee's interviews conducted but not completed and/or lack of employee interviews and especially employee interviews conducted by the compliance staff. The review team could not ascertain if employee interviews were compared against certified payrolls by compliance staff.

When TDHCA monitors grant sub-recipients, onsite computers and a dedicated software package is used to input and organize information obtained during the review process. The software includes a monitoring review tool (a spreadsheet), which guides reviewers to obtain specific data and answer in "yes/no" fashion certain questions pertaining to labor standards. The Testing Tool spreadsheet appears mainly to constitute a transcription of data and misses crucial analysis that would be helpful and visible to auditors or HUD monitors.

Cause: This appearance or lack of documentation may simply be a lack of understanding/training on Federal labor standards requirements, as well as internal communication between the divisions at TDHCA.

Effect: While excellent in concept, the monitoring procedure and the Testing Tool spreadsheet file provided by TDHCA staff could be improved to address significant labor standards issues, i.e. contractor's eligibility, underpayment to employees, and/or overtime issues. In depth documentation, is crucial to the enforcement and administration of the Federal labor standards requirements. These documents were not found in the project files at the time of the onsite monitoring review. If corrections/improvements are not made, TDHCA may fail to properly assess and correct violations of federal prevailing wage requirements, workers due restitution may not obtain redress, and projects may be vulnerable financially.

Corrective Actions: TDHCA must devise and implement revisions to its monitoring procedures, including information obtained through the monitoring process (Testing Tool), rules on follow-up when finding deficiencies or violations during monitoring, and the inclusion of findings or matters of concern in final written monitoring reports. After a follow up conference call conducted on Wednesday, July 28, 2010 the compliance Division has taken action to correct some areas of weakness with the Testing Tool along with monitoring procedures. TDHCA should send its corrective action to this office by September 29, 2010.

Status:

04/21/11 - The Department responded to this finding on December 15, 2010. A letter from HUD dated January 20, 2011 was received by the Department in which HUD stated it had received the response found that the corrective actions taken by the Department "appear to provide a good framework for ensuring adequate administration and enforcement." HUD's Office of Labor Relations is clearing the findings.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
167	8/13/2010 HUD	HOME Federal Labor Standards Monitoring Review June 8-10, 2010 On-site review of TDHCA's federal labor standards administration and enforcement under ap	ix	04/21/11

Division: Program Services

Section:

Issue: Criteria: In accordance with 24 CFR 92.50(a) Responsibilities: The participating jurisdiction is responsible for managing the day to day operations of its HOME program, ensuring that HOME funds are used in accordance with all program requirements and written agreements, and taking appropriate actions when performance problems arise. The use of State recipients, subrecipients, or contractors does not relieve the participating jurisdiction of this responsibility. Additionally, under Reorganization Plan No. 14 of 1950, Federal contracting agencies have day-to-day responsibility for administration and enforcement of the Davis-Bacon labor standards provisions in covered contracts for which they are responsible or to which they provide federal assistance under laws they administer. HUD grants States primary and direct responsibility for the administration of certain labor standards procedural responsibilities.

In accordance with 24 CFR 92.356(b), no persons who exercise or have exercised any functions or responsibilities with respect to activities assisted with HOME funds or who are in a position to participate in a decision making process or gain inside information with regard to these activities, may obtain a financial interest or benefit from a HOME-assisted activity, or have an interest in any contract, subcontract or agreement with respect thereto, or the proceeds there under, either for themselves or those with whom they have family or business ties, during their tenure or for one year thereafter. Person covered apply to any person who is an employee, agent, consultant, officer, or elected official or appointed official of the participating jurisdiction, State recipient, or subrecipient which are receiving HOME funds.

Condition: Construction projects funded/assisted by the HOME program are administered in several ways, of which some grant recipients are owners/for-profit private developers. These owners/developers solicit bids and contract with construction firms to perform construction work. Some developers have their own construction firm and therefore perform their own construction work. According to TDHCA staff, the developers, and sometimes the contractors, review the certified weekly payrolls and conduct confidential employee interviews to determine if they and their subcontractors are in compliance with federal labor requirements.

As a matter of policy, the TDHCA has delegated authority to perform federal labor standards monitoring of construction work subject to the Davis-Bacon and Related Acts, including the collection of confidential data through the employee interview process (use of HUD form 11) to for-profit developers and construction contractors. However, there is no authority by which the State is justified to further delegate enforcement responsibility to the very entities subject to review and possible sanction.

The review team was advised by the TDHCA staff that it is "not unusual" for a for-profit owner to designate a "Labor Standards Officer" (LSO) and for that LSO to be an employee or consultant under contract to the construction company building the project. TDHCA staff further advised, "we pass on-site enforcement responsibilities to the owner" and the "owner selects the LSO." Documentation in the project files confirms this to be the case. However, there is no authority by which the State is justified to further delegate enforcement responsibility to the very entities subject to review and possible sanction. The review team also did not find justification for the possible disclosure of confidential employee information to for-profit owners and to contractors subject to those same federal prevailing wage requirements.

Cause: TDHCA, through the Labor Standards Officer, currently allows for a contractor/developer to oversee certain Labor Standards Enforcement requirements. This causes a certain amount of duties that are not discernibly separate for enforcement actions to be a conflict of interest.

Effect: When problems are found, the LSO cannot make enforcement actions. TDHCA staff did point out that "issues must be pushed up to the State" i.e. incorrect hourly wage rates noted on HUD Form 11(s) and/or overt time noncompliance. At this point, the State takes over and ensures restitution is made. The review team did not find evidence of this to be the case; however the team did find evidence of certified payroll reports (CPR) and employee interview information being passed between contractors for action.

Corrective Action: Compliance monitoring and enforcement actions for which the TDHCA is responsible may not be further delegated to the entities that are subject to review (contractors) or their identity-of-interest affiliates. Therefore, TDHCA must devise and implement procedures to ensure that project certified payrolls review, the performance of employee interviews, and enforcement actions are conducted by appropriate parties under existing authority. The HUD Regional Office of Labor Relations is ready to provide further assistance on this matter. TDHCA should send its corrective action to this office not later than September 29, 2010.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
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Status:

04/21/11 - The Department responded to this finding on December 15, 2010. A letter from HUD dated January 20, 2011 was received by the Department in which HUD stated it had received the response found that the corrective actions taken by the Department "appear to provide a good framework for ensuring adequate administration and enforcement." HUD's Office of Labor Relations is clearing the findings.

168	10/5/2010 Department of E	State of Texas WAP Monitoring Report September 27 through October 1, 2010 Focus on ARRA grant administered by TDHCA under DOE WAP for the purpose of providing
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Status **Target Date**

Px 10/05/10

Ix 04/21/11

Division: Community Affairs

Section: Energy Assistance - WAP

Issue: The sub-grantee must ensure that the audit analyzes all allowable measures as stated in the state plan and ranks them appropriately to ensure that clients receive the full range of weatherization measures that are cost-effective. This "whole-house" approach must take place for every unit. The majority of files reviewed had only two or three measures identified with a SIR of one or greater. This is an improper use of the audit. Some other "low-cost, no-cost" weatherization measures were performed, but the absence of specific air infiltration measures such as insulation and a ranked SIR is of concern to the Project Officers.

Action Item:

TDHCA needs to verify that the EZ-2 audit is run properly until the NEAT audit is implemented. The potential improper use of the assessment tool to identify the correct weatherization measures needs to be addressed as soon as possible. DOE is requesting a corrective action plan demonstrating that training was provided in the correct use of energy audits. DOE is also requesting as part of the action plan, the grantee's plans for remediation of the lax monitoring by the sub-grantee agency.

Status:

04/21/11 - The Energy Assistance Section (EA) instituted the Weatherization Assistant audit program (popularly known as the NEAT audit) for the Texas Weatherization Assistance Program in December 2010, with the caveat to the Subgrantee network that no audits were to be run with any other tool after January 31, 2011. To assure the correct use of the NEAT audit, EA has implemented training in the proper use of the audit to ensure measures are identified and ranked properly and the whole house weatherization goal to achieve the greatest energy efficiency is attained. This finding has been cleared by DOE.

10/05/10 -

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
169	10/5/2010 Department of E	State of Texas WAP Monitoring Report September 27 through October 1, 2010 Focus on ARRA grant administered by TDHCA under DOE WAP for the purpose of providing	Px	10/05/10
			Ix	04/21/11

Division: Community Affairs

Section: Energy Assistance - WAP

Issue: The payment to a contractor for a window which was not installed constitutes a finding and is fraudulent because the program reimbursed a contractor for reported expenses on a measure which was not installed.

Action Item:

TDHCA must investigate and provide to DOE evidence that the costs for this window were disallowed and that those funds have been reimbursed by the agency to the program. We are requesting this information no later than thirty days from the receipt of this report.

Status:

04/21/11 - The Energy Assistance Section (EA) disallowed this cost and required the Subgrantee to provide evidence of payment from a non-federal source of funds in order to reimburse the program. This has been done and copies of the check, the deposit, and the ledger entries to reverse the previous payment and post the new payment have all been provided to the DOE Project Officer. In addition, the Subgrantee response indicates that future inspections will entail a more thorough inspection and validation of the measures installed prior to payment of invoices. This finding has been cleared by DOE.

10/05/10 -

170	11/23/2010 Department of E	DOE On-Site Monitoring Report for State of Texas November 15 through 19 2010 DOE WAP and ARRA WAP monitoring review of programmatic, administrative and financial		
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Division: Community Affairs

Section: Energy Assistance - WAP

Issue: The NEAT audit was run improperly. Measures were ranked which would not ordinarily rank with proper, accurate input used in the audit. The replacement of HVAC units ranked because the electric "whip" and a concrete pad were moved to the Health and Safety portion of the audit. These are not H&S measures.

Recommended Corrective Action:

DOE is requesting a response containing the State's corrective action plan with their timeline for follow-up and correction of this misuse of the audit tool within 15 days of receipt of this report. (10 CFR 440.16(h)) and 10CFR 440.14(6)(xi)

Status:

04/21/11 - The finding was resolved due to intensive NEAT audit training provided to both the City of Austin and Travis County to resolve the misconception that moving parts of the assessment to the Health and Safety portion of the audit is an acceptable practice. The identification by EA in the monitoring report of further abuses of HVAC replacements and efforts to ensure audits are run appropriately combined with disallowed costs provides satisfactory evidence that the finding is resolved.

11/23/10 -

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
171	11/23/2010 Department of E	DOE On-Site Monitoring Report for State of Texas November 15 through 19 2010 DOE WAP and ARRA WAP monitoring review of programmatic, administrative and financial	Px	11/23/10
			Ix	04/21/11

Division: Community Affairs

Section: Energy Assistance - WAP

Issue: An HVAC unit was replaced at 2014 Berkett Drive #210 in Austin. (Work Order COA 0169/1) The existing unit was thought to be a 1.5 ton unit. It was replaced with a 2 ton unit but the program was charged \$3,578 for a 2.5 ton unit.

Recommended Corrective Action:

DOE requires a response from TDHCA containing their corrective action plan with their timeline for follow-up, correction of this action and reimbursement to the program within 15 days of receipt of this report. These costs should be disallowed.

Status:

04/21/11 - The finding was resolved due to intensive NEAT audit training provided to both the City of Austin and Travis County to resolve the misconception that moving parts of the assessment to the Health and Safety portion of the audit is an acceptable practice. The identification by EA in the monitoring report of further abuses of HVAC replacements and efforts to ensure audits are run appropriately combined with disallowed costs provides satisfactory evidence that the finding is resolved.

11/23/10 -

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
172	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 5/30/2011
			Px	04/22/11 5/30/2011

Division: Neighborhood Stabilization

Section:

Issue: Three NSP quality assurance specialists in Program Services have both level one and level two authorities to approve activity setup, amendments, and draws. This means that the quality assurance specialist could enter an activity into the Housing Contract System and also approve the same transaction. Separating responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets will help mitigate the risk of errors and irregularities and assist in safeguarding assets.

Recommendation:

NSP should ensure individuals who enter activities into the Housing Contract System do not also have the authority to approve the transactions that they set up.

Status:

- 04/22/11 - On February 28, 2011, Information Systems (IS) completed the first step in the resolution of this finding by adjusting the PM1 and PM2 roles in the Housing Contract System (HCS) to ensure that no TDHCA NSP staff member currently possesses a Quality Assurance (PM2) role. Therefore, NSP staff members who enter activities in HCS do not also have the authority to approve the transactions they set up. NSP will maintain separation of duties by ensuring that staff who enter activities do not also have the authority to approve the transactions they set up. With the completion of the first-step involving corrections to current assigned roles in HCS, the second and final step is to revise existing SOPs to ensure that HCS approval roles do not overlap again. The final step will be completed by May 30, 2011.
- 04/08/11 - Management concurs. Overlap of authority in the Department's dual approval authority has occurred in the Program Services Division as a result of the administration of another program. Management will ensure that the separation of duties for the entry and approval of draws and set-ups in the Housing Contract System (HCS) are re-established and staff duties reassigned to restore checks and balances by March 31, 2011. Management will review and edit existing draft SOPs concerning HCS procedures or new SOPs will be created to ensure that these roles do not overlap again. The applicable SOPs will be developed and finalized by May 30, 2011.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
173	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 5/31/2011
			Px	04/22/11 5/30/2011

Division: Neighborhood Stabilization

Section:

Issue: NSP does not have an established mechanism in place to track key elements of the program including contract milestone thresholds, cumulative budget transfer amounts, and homebuyer loan files. Although the NSP Technical Guide states that the Department will evaluate compliance with contractual obligations to ensure progress toward meeting benchmarks, NSP is not consistently tracking the subgrantee's milestones. Subgrantees are not always meeting their milestones. HUD requires grantees to obligate and expend funds in an expeditious manner and HUD has imposed a deadline for expending grant funds. In one instance, the subgrantee should have expended 30% (\$600,000) of its demolition obligation by May 31, 2010 and 30% (\$153,397) of its purchase and rehabilitation obligation by August 31, 2010. As of January 10, 2011, all the contract activities entered in the Housing Contract System for this subgrantee are still in pending status. The subgrantee has not drawn any funds to support meeting the 30% expended funds. This is significant because if the NSP fails to expend the grant funds within the established timelines, the funds will be recaptured by HUD, the subgrantees' geographic area will not be served, and the Department may not achieve the program objectives. NSP is also not formally tracking incremental budget transfers. The NSP contract with subgrantees indicates that there is a 10% budget transfer ceiling. Transfers above 10% require an amendment or written authorization from the Department. Transfers above 25% require approval of the Department's governing board. When the cumulative amount of budget transfers is not monitored, program specialists and management may not identify incremental budget transfers that exceed the allowable limits and may neglect to obtain the appropriate level of approval.

There is no centralized mechanism to track the progression of homebuyer loans through the inter-divisional, multi-step closing process. Individuals involved in NSP loan processing have developed their own tools to track these loans.

NSP does not have a system or report that captures the entire population of NSP transactions. No single resource can be used to determine the status of the program or to review complete information about a specific transaction.

If NSP does not sufficiently monitor these key elements, there is an increased risk that the program may not stay on track and that the program objectives will not be completely achieved. Missed milestones could result in the loss of funding. Budget transfers could exceed the 10% ceiling, which may prevent the amendment from receiving approval as required. Homebuyer loan files could fall through the cracks and result in delayed closings or unnecessary re-work.

Recommendations:

NSP should:

- Establish a system for tracking key program elements,
- Ensure grant funds are expended within the program guidelines and within the program timeframe, and
- Monitor contract milestone thresholds, cumulative budget transfer amounts, and the status of homebuyer loan files.

Status:

- 04/22/11 - Program Services is working to complete the reconciliation of the Housing Contract System and DRGR, at which point a baseline tracking system will be established. The tracking system will track key program elements to ensure that milestones are met, loan documents are tracked and cumulative budget transfers are accurately processed. These processes will be incorporated into an SOP.
- 04/08/11 - Management concurs. Management will establish a system for tracking key program elements and formally incorporate the procedures into an SOP by May 31, 2011 in order to better track subrecipient performance and compliance. Management will prepare a budget transfer reconciliation report for the May 2011 TDHCA Board meeting and request, if necessary, authorization for any already identified transfers at that meeting and will establish a more uniform process to manage cumulative budget transfers by May 31, 2011.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
174	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 8/31/2011

Division: Neighborhood Stabilization

Section:

Issue: NSP does not have detailed policies and procedures. The limited number of written policies and procedures NSP does have are all in draft form and have not been formally communicated to staff including SOPs for contract amendment requests, draw requests, set-up requests, contract administration, mortgage loan financing, home buyer assistance loans, and obtaining credit reports. SOPs that have been finalized have not been formally communicated to staff. Without finalizing and formally communicating policies and procedures to the NSP staff, staff may not be performing their job duties as intended by management. NSP management's finalization of the policies are necessary to ensure that all program specialists are performing their duties in accordance with standardized instructions, that program specialists perform their duties consistently and effectively, and that risks are mitigated.

Recommendation:

NSP management should finalize, communicate, and monitor compliance with the program's written policies and procedures.

Status:

04/08/11 - Management concurs. Management will reevaluate the four existing draft SOPs, edit or create new SOPs as appropriate and finalize and communicate the SOPs to staff by May 30, 2011. Management will provide training on the SOPs for staff once they have been finalized. Management will establish a process for periodic sampling and testing to ensure compliance with written policies and procedures by August 31, 2011.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
175	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 5/30/2011

Division: Neighborhood Stabilization

Section:

Issue: Pertinent information is not always effectively shared among NSP staff and with others that support the program. Communication between NSP and the subgrantees also appears to be challenged. Subgrantees commit to move-in dates and deadlines with prospective homebuyers without consulting the Department. As a result, NSP and the Legal Division are often rushing to meet deadlines they did not set. This process puts undue pressure on the Department's staff to complete work under unreasonable timelines and increases the risk of errors or omissions.

Other barriers to effective communication and information sharing include:

- Regular NSP team meetings are not conducted,
 - Policies and procedures have not been finalized and communicated to staff, and
 - The NSP Program Manager possesses significant program knowledge that is not documented or communicated to staff.
- There is a general feeling from other divisions in the Department that communication with the NSP staff is not always as effective as it could be. Effective communication supports all the other control components by communicating responsibilities to employees and by providing information in a form and timeframe that allows employees to carry out their duties effectively. If staff is not adequately informed, they may be unable to fulfill their duties and the program may be impacted.

Recommendation:

Communication within NSP and with other key stakeholders should be enhanced. NSP should:

- Instruct subgrantees to communicate with the Department prior to setting deadlines for move-in with homebuyers,
- Conduct regular team meetings (inviting both Program Services and Legal Division staff) to discuss both broad and specific program-related issues,
- Finalize and effectively communicate the draft policies and procedures, and
- Share pertinent information with other staff.

Status:

04/08/11 - Management concurs. Management will enhance the communication of program procedures and requirements with stakeholders, subrecipients and staff through conducting trainings, regular staff meetings and the development and finalization of written program guidance.

From November 30, 2010 through December 9, 2010, NSP staff conducted four mandatory trainings in Austin, Dallas, Houston and McAllen for all NSP subgrantees that will be reselling NSP properties. The trainings included the requirements for setting deadlines for move-in with homebuyers and established a specific email address (nsphdocs@tdhca.state.tx.us) to facilitate homebuyer procedures that were not being adequately and timely communicated due to limitations of the Housing Contract System. NSP will continue to schedule trainings and webinars and offer direct technical assistance where performance issues with subgrantees are identified.

Management will review and revise the NSP Technical Manual to provide an enhanced roadmap for subrecipients by May 30, 2011.

Management also concurs that effective internal communication is vital to the continued success of the NSP, helping to balance workload priorities and available time and staff resources. Management will work to ensure that communication regarding the timelines for closing activities is well understood by all internal staff and coordinated with external participants in the program.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
176	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 5/30/2011
			Px	04/22/11 5/30/2011

Division: Neighborhood Stabilization

Section:

Issue: Chapter 2-A
Budget Amounts in DRGR and the Housing Contract System Should be Reconciled

The Department may not be reporting accurate information to HUD. There were discrepancies in the total budgeted amounts recorded in the Department's Housing Contract System and the budgeted amounts recorded in the DRGR system. Of the 52 contracts that we compared in both the DRGR and Housing Contract System, differences were noted in 26 contracts (50.0%). Four contracts had differences of \$1 million or more. One contract differed by more than \$5 million. Two contracts were entered into the DRGR system but were not in the Housing Contract System and one contract was entered into the Housing Contract System but was not in DRGR. Overall, there was a total difference of \$2,313,071 more in the DRGR system than in the Housing Contract System.

HUD requires each grantee to report on its NSP funds using the DRGR system. HUD uses grantee reports to monitor for anomalies or performance problems that suggest fraud, waste, and abuse of funds and to reconcile budgets, obligations, fund draws and expenditures.

A reconciliation of the data in the DRGR system, the Housing Contract System, and the contract file does not occur on a regular basis. Only two reconciliations were performed as of November 5, 2010. Both were performed in connection with an external audit by HUD. However, in both of these reconciliations, the data was not reconciled in the aggregate at the program level, only at the individual contract level. Without regular reconciliations, contract information in the Department's Housing Contract System will not be consistent with HUD's DRGR system or with the hard copy files.

The program manager is responsible for submitting program reports to HUD using the DRGR system. The program manager is also responsible for entering contract budget corrections into both DRGR and the Department's Housing Contract System. Ideally, these functions should be separated. When one person has the ability to enter data into the Housing Contract System and DRGR, there is a higher risk that data entry errors go undetected. Regular and routine reconciliations should identify data entry errors.

Lack of regular reconciliations may prevent management from having accurate performance information available for decision-making and for reporting to HUD. A regular reconciliation process ensures that data is accurate and that unauthorized changes have not occurred.

Recommendations

NSP should perform regular and routine reconciliations between the data in the Housing Contract System, the data in the DRGR system and the hard copy files. At a minimum, these reconciliations should include:

- reviewing source documents,
- verifying the accuracy and recording of the transactions in the Housing Contract System,
- comparing DRGR to the Housing Contract System,
- identifying and resolving any discrepancies in a timely manner,
- documenting the performance of reconciliations,
- reviewing the reconciliations to ensure they are performed and any discrepancies are resolved, and
- ensuring the individual performing the reconciliation does not also enter data into either of the data systems being reconciled or have the ability to process transactions.

<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
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Status:

- 04/22/11 - Until all NSP funded activities can demonstrate a final eligible use benefit, TDHCA's Housing Contract System (HCS) and HUD's Disaster Recovery Grant Reporting System (DRGR) will diverge. In order to minimize this divergence, an SOP to reconcile the two database systems at the aggregate level on a monthly basis is under development and will be provided by the May 30, 2011 target date.
- 04/08/11 - Management concurs. Program Services staff is currently in the process of reconciling the contract system with DRGR, and the responsibility for completing HUD reporting from the DRGR system is being reassigned to a staff member in Program Services. A full reconciliation is anticipated to be complete by April 30, 2011. Management will review existing draft SOPs to edit or create a new SOP to ensure that a process exists for the two systems to be reconciled on a monthly basis thereafter; associated SOPs will be finalized by May 30, 2011

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
177	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 5/30/2011

Division: Neighborhood Stabilization

Section:

Issue: Chapter 2-B
Data in the Housing Contract System Should Accurately Reflect the Status of the Contracts

The contract status in the Housing Contract System does not always reflect the actual status of the contract. We randomly selected a sample of 48 NSP contracts for testing purposes. The status of 18 of the 48 (37.5%) contracts reviewed in the Housing Contract System (and using the hard copy contract files) was inaccurate. The status should be classified as "pending" "active" "closed" or "terminated for cause" depending on the situation.

We found that of the 18 inaccurately classified contracts:

- Ten contracts expired on November 30, 2010. According to NSP and TDRA management, amendments are in process. These contracts should be classified as pending amendment or inactive but were still labeled "active."
- Four files were labeled as closed, but there was no formal documentation scanned in the Housing Contract System to support closing the project.
- Two files were labeled "terminated for cause" but should be "closed."
- One file labeled "active" should be "closed."
- One contract was not yet entered into the Housing Contract System; therefore no status was available.

The status in the Housing Contract System should agree to the actual status of the contract. When triggering events such as contract expiration or contract termination occur, the status in the Housing Contract System should be revised and the correct classification should be used. Documentation supporting the triggering event should also be entered into the Housing Contract System.

NSP staff does not always update the Housing Contract System when triggering events occurred such as contract expiration or voluntary termination. As a result, program managers who use the data in the contract file and the Housing Contract System for decision-making may not be relying on the correct data.

Recommendation

NSP should ensure that the contract status in the Housing Contract System accurately reflects the status of the contract.

Status:

04/08/11 - Management concurs. Management will review and amend existing draft SOPs regarding contract status in the Housing Contract System to ensure that a clear procedure exists for timely and accurate updates to HCS and implement a monthly review as part of the monthly reconciliation process discussed as part of response to recommendation 2A.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
178	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 5/31/2011

Division: Neighborhood Stabilization

Section:

Issue: Chapter 2-C
Supporting Documentation Needs to be Available in the Housing Contract System

Data in the Housing Contract System is often unavailable. Documents supporting the contract setups and draws, and the actual amendments themselves were not always present in the Housing Contract System. For instance, imaged documents for the budget amendments was not available in the Housing Contract System for 17 of 28 (60.7%) sub-recipient contracts reviewed. As a result, accounting and other program personnel periodically have to track down documentation supporting executed amendments on a case-by-case basis.

Supporting documentation for setups was not always available in the Housing Contract System. Examples of setup documents that were unavailable include:

- 26 of 48 files (54.2%) did not include evidence of environmental review, (Of these 26 files, 21 were TDRA files), and
- 5 of 48 files (10.4%) did not include contract termination documents, although the contracts were (or should have been) terminated.

Draw documents not included in the Housing Contract System are discussed in Chapter 3-C.

The draft NSP procedures require that supporting documentation be entered into the Housing Contract System. Expecting program staff and other Department staff to track down documentation that should be available in the Housing Contract System is time consuming and inefficient. As a result, users of the Housing Contract System may rely on incorrect data because the information in the system is incomplete or unavailable.

Recommendation

NSP should:

- ensure that all supporting documentation is submitted by both the Department and TDRA and available in the Housing Contract System, and
- finalize, communicate and enforce the procedures that require supporting documentation to be entered in the Housing Contract System.

Status:

04/08/11 - Management concurs. Management will review and edit existing draft SOPs or create new SOPs to ensure that all required supporting documentation is submitted and available in the Housing Contract System. All checklists will be reviewed and edited, as necessary, to facilitate the process and provide a clear understanding of the required documentation. Associated SOPs and checklists will be finalized and communicated to staff and subgrantees by May 31, 2011.

Management will establish a process for periodic sampling and testing of the Housing Contract System by August 31, 2011 to ensure that all required supporting documentation is present.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
179	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 5/30/2011
			Px	04/22/11 4/29/2011

Division: Neighborhood Stabilization

Section:

Issue: Chapter 2-D
NSP Should Ensure that Supporting Documentation is Available to Verify that HUD Obligation Requirements were Satisfied

NSP does not maintain a listing, outside of the Housing Contract System, of the addresses and/or household names that were used to obligate the NSP funds by the September 3, 2010, deadline for obligations. NSP relies on the information in the Housing Contract System to record obligations. However, the Housing Contract System is constantly in flux and does not maintain a complete historical record of information. Therefore, we were unable to determine accurately the original population of awards obligated by the September 3, 2010, deadline. Because we could not determine the obligation population, we could not confirm compliance with the HUD requirements.

The Housing and Recovery Act of 2008 requires grantees to use NSP funds within 18 months of when HUD signed its NSP grant agreement. For the Department, the 18- month period ended September 3, 2010. Funds are considered used when they are obligated by a grantee. HUD requirements include ensuring each obligation can be linked to a specific address. The obligation for each eligible use must be further evidenced by a specific event. For example, acquisition and landbank costs are considered obligated when the seller has accepted the purchase offer. Demolition costs can be reported as obligated when the subrecipient awards a demolition contract. A subrecipient's rehabilitation costs can be recorded as obligated when a construction contract is awarded for a specific property. To test the evidence of obligation, the population of obligations must first be identified. Because a listing of addresses and/or household names was not maintained outside of the Housing Contract System, the population of obligations could not be easily determined.

Recommendation

NSP should ensure that the Department has documentation in place to support the obligation information reported to HUD.

Status:

- 04/22/11 - A full reconciliation between HCS and DRGR is in the final stages of production and will be completed by April 29, 2011. Obligations reported in HCS are being reviewed by the Quality Assurance section of Program Services to ensure that obligation amounts reported in DRGR are supported with appropriate documentation.
- 04/08/11 - Management concurs. Management has charged Program Services with the responsibility for re-evaluating and reconciling the documentation provided to recertify the obligations made as of the obligation deadline by April 30, 2011

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
180	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	ix	04/08/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 2-E
Generic Data in the Housing Contract System Should be Replaced

Generic data is entered into the Housing Contract System in the household name field for NSP contracts. We tested 1,725 entries in the Housing Contract System and identified 1,188 (68.9%) with generic data in the household name field. Examples of generic data include: "unknown," "not applicable," "TBD," or the street name.

The Housing Contract System requires an entry in the household name field in order for the entry to be completed. However, the NSP subgrantees do not always have this data available at the time of the data entry because the household name may not be determined until the completion of the project.

The Information Systems Division has scheduled modifications to the Housing Contract System that will allow a contract to be setup without using generic data. If the generic data that is entered into the Housing Contract System is not replaced with the actual data once it is known, then the data that is in the system will not be reliable. In addition, if the generic data is not standardized, then it will be difficult to identify all entries that have generic data in the household name field and will require a more in-depth analysis to ensure that all of the generic data has been replaced with the correct information once the system is modified.

Recommendations

NSP staff should ensure that:

- the generic data entered into the Housing Contract System is replaced by the correct data once it is known.
- the subgrantees are consistent in the use of generic data entered into the household name field to ensure that all generic data is identified and corrected.

Status:

04/08/11 - Management concurs. After the field work for the audit was completed changes to the Housing Contract System were implemented to remove the requirement that generic data be entered in certain fields in order for the system to accept the activity setup. As the generic data fields all tie to homebuyer transactions, they will be corrected to include homebuyer information as the properties are resold. Training on both of these issues has also been provided to all subgrantees and the need for additional training will be monitored by the Program Specialist as they approve future activity set ups

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
181	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 3-A
The Department Should Review TDRA Draws Prior to Payment

Draws initiated by TDRA go directly to the Department's Accounting Operations staff for payment processing. NSP staff do not review these draws prior to payment. TDRA is responsible for the administration of no more than \$19,981,500 (19.6%) of the \$101,996,848 NSP grant from HUD.

The MOU between the Department and TDRA states that the Department will monitor TDRA's oversight of their subgrantees to ensure that activities are completed, performance goals are met and funds are expended in accordance with program requirements, contract provisions, applicable state and federal rules, regulations, and policies.

Since the draws initiated by TDRA are not reviewed by NSP staff prior to payment, there is a higher risk that those draws may not be processed correctly or within the program's requirements. The Department is responsible for the overall NSP grant from HUD, including the draws initiated by TDRA.

Recommendation

NSP should implement a monitoring process for all draws initiated by TDRA to ensure that the draws are processed correctly and within the program's requirements prior to payment by Accounting Operations staff.

Status:

04/08/11 - Management concurs with the need for robust monitoring of TDRA, but the MOU with TDRA requires TDRA to have sufficient and appropriate controls for their draw process and holds them solely responsible for their draws. The Department's Compliance and Asset Oversight Division is scheduled to monitor TDRA and their subgrantee's NSP activities in March of 2011 and expect to have a report for management by the end of April. Management will ensure that the monitoring plan for TDRA's program contains a review of TDRA draws and will offer training and technical assistance to TDRA to address any deficiencies observed as part of the monitoring review

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
182	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 3-B
Timeliness of the Draw Process Should Be Improved

Not all electronic draws are reviewed and approved or disapproved within five business days of submission as required by NSP's draft policies and procedures. We judgmentally selected 77 draws for testing purposes. Of the 77 draws we tested, 18 (23.4%) were not processed within five working days; the longest time delay was forty-two working days. We tested closing fund draws, construction draws, activity delivery draws, set-up checklist draws and draws for administrative expenses. These draws cover each of the five different eligible uses (financing mechanisms, acquisition and rehabilitation, land bank, demolition, and redevelopment) plus administrative expenditures.

- Of the 31 closing fund draws tested, six (19.4%) were processed after the five -day requirement, with eight days as the longest delay.
- Of the five construction draws tested, all were processed within the five-day requirement.
- Of the 13 activity delivery draws tested, one draw (7.7%) took an additional fourteen days to process.
- Of the 18 set-up checklist draws tested, seven (38.9%) were processed after the five-day requirement, with four days as the longest delay.
- Of the ten administrative expenditure draws tested, four (40.0%) were processed after the five-day requirement with forty-two days as the longest delay.

If draws are not processed in a timely manner, then subgrantees may not be able to meet their obligations because the program uses a reimbursement basis.

Recommendation

NSP should ensure that all draws are processed within the required timeframe.

Status:

04/08/11 - Management concurs that draws should be accurately and timely processed. Since the audit field work was completed, Management has re-assigned staff to improve the processing of draws. Management believes the revised process will ensure that the draws will be processed within the five days and will test to ensure that this is the case on a monthly basis, making additional adjustments to the process if needed

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
183	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 8/31/2011

Division: Neighborhood Stabilization

Section:

Issue: Chapter 3-C
Draw Documentation in the Housing Contract System Should be Complete

The Housing Contract System is the automated system used by the Department to track housing activities. NSP uses the Housing Contract System to track the program's contracts, activities, and draws. We reviewed draw documents in the Housing Contract System to determine if all of the required documents were available and found that there were documents missing for three of the five types of draws we tested. We did not find any missing documents for set-up checklist draws or for construction activity draws.

Examples of missing documents include:

For the closing fund draws,

- 19 of 31 (61.3%) tax (payee) ID forms,
- 6 of 31 (19.4%) comptroller letters, and
- 5 of 31 (16.1%) borrower authorization letters were not on file.

For the activity delivery draws,

- 8 of the 13 (61.5%) draws tested did not have evidence of the single audit certificate.

For the administrative draws,

- 1 of the 7 (14.3%) administrative expenditure draws with salary costs did not provide either the payroll journals or cancelled checks to support the expenditures.

HUD requires that the Department maintain information on all draws, deposits and expenditures of grant funds. In addition, the NSP's draft procedure for draw requests requires that complete supporting documentation be received in order for a draw to be approved. Without the required supporting documentation, NSP does not have assurance that staff are processing draws accurately and within the program's requirements.

Recommendation

NSP should ensure that the required supporting documentation is available in the Housing Contract System prior to approving payment of the draw.

Status:

04/08/11 - Management concurs that required supporting documentation should be attached to all draws prior to processing of payments. For TDHCA transactions two independent approvals (one by the NSP Program Specialist and one by the Quality Assurance Specialist in Program Services) of the supporting documentation are required for each draw. By August 31, 2011, the manager of NSP and the Director of Program Services will establish a process for periodic sampling and testing process of draws to ensure proper documentation has been included and to provide training for staff and subgrantees if such documentation is found to be missing.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
184	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 3/31/2011
			Px	04/22/11 4/29/2011

Division: Neighborhood Stabilization

Section:

Issue: Chapter 3-D
Draw Checklists Should be Used Effectively

The checklists used by NSP staff to process draw requests do not have enough detail to guide NSP staff on how to process these draws. There is not a checklist for every draw type, staff do not always use the checklists consistently, and the checklists are not always signed by staff. Use of NSP's draw request checklists could be improved to ensure they provide clear and detailed guidance to NSP team members. NSP developed checklists to guide subgrantees in submitting their draw requests and to serve as a reference for NSP staff as they process draws. The checklists are supposed to cite the required supporting documentation and list any verifications the NSP staff must make prior to approving a draw.

Draw request checklists need more detail to guide NSP staff on how to process draws. The draw request checklists do not outline the specific items that NSP staff should verify within the supporting documents. The checklists also do not reference the requirements or criteria against which the requests and support should be reviewed. For example, checklists include boxes that list verifications that the reviewer should perform, such as agreeing amounts with the Housing Contract System, but they do not provide guidance on the approved methodology for reviewing the listed supporting documentation. Reviewers are required to sign off to verify review of these documents. It is not clear if the reviewer's signature indicates verification of the existence of the documentation or of the adequacy of the documentation.

NSP needs a checklist for every draw type. NSP has four checklists in place to handle the six types of draws. Three draw types do not have specific checklists: demolition expense draws, purchase and rehabilitation draws, and land bank cost draws. For demolition draws, subgrantees typically submit either the Demolition Set-up Checklist or the Construction Draw Request Checklist. Depending on which checklist a subgrantee uses, the criteria used to submit and evaluate the draw will vary. As a result, subgrantees and NSP staff do not have clear guidance as to what documents and benchmarks are required for a demolition draw request to be accurately approved. However, the purchase and rehabilitation as well as the land bank draws can be covered by one of the existing checklists. Although it would be better for these draw types to have their own individualized checklist, the absence of one does not appear to be jeopardizing compliance or hindering operations.

NSP staff use either the Closing Fund Draw or the Set-up Checklist when processing a closing fund draw. NSP staff are not using the Closing Fund Draw Checklist to process all closing funds. The Closing Fund Draw Checklist and the Set-up Checklist require different types of documentation to be provided in order for the draw to be processed. Therefore, the closing fund draws are not being processed consistently and the subgrantees may not have submitted all of the supporting documentation needed to process the draw. The draft NSP procedure related to draw requests states that the program specialist is responsible for ensuring that the supporting documentation is received as required by the appropriate draw request checklist.

Without documented guidance in place, the subgrantee may not be aware of all requirements necessary for their draw requests. Similarly, without references in place, NSP staff responsible for processing draws may not have a firm knowledge of the items required to support a draw. As a result, there is a risk that staff may approve draws for ineligible costs.

NSP and TDRA staff should complete the draw checklists consistently. Of the 77 judgmentally selected draws tested, 40 (51.9%) did not have completed checklists, and 16 (20.8%) checklists were not signed by the program specialist. The draft NSP procedure related to draws states that if the electronic setup is acceptable, then the program specialist will complete the draw request checklist. Without the signature of the program specialist affirming their review of the supporting documentation for the draw, NSP may be unable to determine if the supporting documentation was reviewed for accuracy and allowability prior to the approval of the draw by the program specialist. The use of checklists continually reminds staff of the job requirements. It is a systematic way to make sure the activities are completed correctly and provides written documentation to support this assertion.

Recommendations

NSP should improve the use of draw checklists by:

- modifying checklists to accurately document the draw requirements,
- developing comprehensive checklists for all draw request types, and
- ensuring that all draw checklists are completed correctly.

Status:

- 04/22/11 - NSP draw checklists have been reevaluated and edited as appropriate for the following draw types: Administration, Activity Delivery, Closing and Construction. The edits have been performed in coordination with the Program Services Division. The updated checklists will be added to the NSP Forms Library on the website by April 29, 2011, and simultaneously a broadcast email will be sent to all subgrantees informing them of the revisions.
- 04/08/11 - Management concurs. Management will re-evaluate and edit checklists as necessary to be specific for each of the following draw types: Administrative, Activity Delivery, Closing and Construction Draws.

The revised checklists will be implemented by March 31, 2011, and staff will continue to provide training and technical assistance to subgrantees in person and via webinar.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
185	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 4-A
The Department Needs Increased Resources to Meet the Deadline for Loan Closings

There are no formal timing requirements or goals in place for loan closing. Based on workload estimates provided by NSP management, there is not enough staff to close all the loans by the August 31, 2011 initial closing deadline.

NSP has four staff for loan closers. However two have additional responsibilities apart from closing loans. It is possible to process a homebuyer loan in 45 working days (or nine weeks) from underwriting to closure. This includes the 30 days required by legal for loan document preparation and review. In the private sector, it takes approximately two weeks to process a homebuyer loan and full-time loan processors can complete ten to fifteen closings each month. It is important to note that non-homebuyer transactions can be more complex and may require more time and effort for the loan closer. To assess the feasibility of meeting the August 31, 2011 deadline, we considered different staffing scenarios for processing the estimated 400 loans and concluded that it is highly unlikely that NSP will be able to meet the deadline with the current staffing level.

The average workload used for comparison purposes is the average estimated workload for private sector loan closings. Assuming that the private sector processes loans at a faster rate (two weeks), and comparing this rate to the Department's minimum nine-week process, the feasibility of NSP meeting the deadline at their current staffing level is further diminished. In addition, since the loan closers cannot begin the closing process until the subgrantees have submitted a setup, it is unlikely that the anticipated workload will be evenly distributed over the coming months. It is more likely that as the deadline approaches more and more setups will be submitted for processing, creating longer delays and a larger backlog.

If NSP is unable to close the estimated number of loans by August 31, 2011, homebuyers awaiting closings could be without housing or incur additional expense in finding a temporary place to live.

Recommendation

The Department should re-evaluate the resources of the NSP and reallocate staff as necessary to ensure that there are an adequate number of loan closers to complete the anticipated influx of closings. In addition, NSP should redistribute responsibilities to ensure that employees who conduct homebuyer loan closings can focus primarily on that task.

Status:

04/08/11 - Management concurs and has re-allocated staff resources in order to ensure that homebuyer transactions are processed timely. Management will monitor workflow and as bottlenecks are forecast and identified, adjust resources to focus on the portion of the closing effort that is affected.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
186	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 4-B
The Workload for the Legal Division's Loan Document Preparation is Challenging

To ensure NSP's priorities are met, staff from legal created a tracking sheet of all files in its queue, which is updated regularly to reflect NSP's changes. The tracking sheet indicates that the queue has more than twice the number of "rush files" as it does files that are "pushed back" to allow for rushed jobs. Seven of the 46 files listed in legal's queue (15.2%) include comments stating that they were returned to NSP for revisions or confirmations. In many cases, legal had already started work on the files when they had to be returned.

In mid-December, legal released a Memorandum of Understanding (MOU) between NSP staff and legal staff regarding loan file workflows. The MOU requires program staff to meet with legal staff on a weekly basis to coordinate reasonable workloads, prioritizations, and projected work volumes. However, priority changes within NSP are occurring on a daily, rather than weekly basis.

The changes in priority and the number of "rush files" occurs because subgrantees commit to move-in dates and deadlines with prospective homebuyers without consulting the Department. As a result, NSP and legal are often rushing to meet deadlines they did not set. Legal is pursuing outside counsel to assist with the loan document preparation for approximately 400 incoming loans. Therefore, legal's workload will likely change once the outside counsel is hired.

The unreasonable workload could result in missing deadlines, a diminished quality of work, excessive overtime, a high burn-out rate, and the potential loss of experienced staff in both NSP and legal.

Recommendations

NSP should require subgrantees to communicate with the Department prior to setting deadlines for move-in with homebuyers. Move-in dates should be set after the loan documents are completed and ready for closing. In addition, NSP should take full ownership of reorganizing files to its preferred order for legal processing, thus alleviating the current back-and-forth between the two areas and freeing up the legal staff to focus on the preparation of loan documents.

Status:

04/08/11 - Management agrees and is in the process of clarifying the responsibilities of program staff, Program Services staff, and Legal Services to promote efficiency, avoid duplicative efforts, and improve the coordination and scheduling of loan closings. As noted in the response to 1-D, subrecipient training and additional resources have been established to increase the communication surrounding loan closings. These actions will ensure a more predictable workflow and closing timeline. Legal Services, NSP, and Financial Administration are also assessing the possibility of adding to the Legal Services staff within existing budgetary and FTE constraints. Additionally, management is concluding a procurement process to secure an outside laws firm to assist in preparing closing documents for homebuyer transactions under NSP.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
187	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 4-C
NSP Loan Files Provided to Legal Should be Complete and Accurate

Key support, such as contracts and environmental clearance certifications, are often missing from the loan files when NSP forwards the files to legal. NSP Loan Closing Specialists attach a "Request for Preparation of Loan Documents and Closing Instructions" form to loan files provided to legal. The form provides general information on the files' contents. We compared the NSP form to the documentation that legal needs for homebuyer loan preparation. The form did not include many of the items needed by legal, including subgrantee contract information, indication of environmental clearance, and indication that the purchase discount was satisfied or waived.

NSP has been largely focused on productivity. High production appears to have an impact on the quality of work. The risk of error is heightened by the lack of mitigating controls such as formalized policies and procedures (see Chapter 1-C.)

The responsibility for ensuring the accuracy of the information in the files lies with the NSP. If information in the loan file is not correct and the error is not caught by legal, inaccurate or incomplete homebuyer loans could be closed and funded, NSP money could fund non-compliant transactions, or NSP may unknowingly report incorrect information to HUD.

Recommendations

NSP should:

- enhance quality assurance reviews on the front end of the homebuyer loan closing process to ensure that issues are caught and corrected before files are sent to legal, and
- amend the "Request for Preparation of Loan Documents and Closing Instructions" form to include a comments section and checkboxes to indicate the file includes all of the items required by legal in order to prepare homebuyer loan documents.

Status:

04/08/11 - Management concurs. Management will ensure the standardization of documentation to be reviewed by Legal Services and existing checklists will be reevaluated and revised in coordination with Legal Services to ensure that files are complete for each transaction. The clarifications now being finalized will clearly delineate the documents that will be required (to enable subgrantees to gather them), the review to be performed by Legal Services, and the programmatic reviews that will be performed by NSP and/or Program Services.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
188	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 5-A
The 2009 Annual Section 3 Summary Report Should be Submitted to HUD

NSP did not collect Section 3 data for 2009. Section 3 of the Housing and Urban Development Act of 1968 requires the Department and its subgrantees to give priority consideration in awarding jobs, training, and contracting opportunities to low- and very low-income persons who live in the community in which the funds are spent. NSP contracts have been in place since September 1, 2009, but Subrecipient Activity Reports used to collect Section 3 data were not modified to capture the required data until March 31, 2010.

We tested 23 randomly selected Subrecipient Activity Reports submitted since April 2010 and found that only 12 (52.2%) of the reports submitted by the subgrantees in our sample used the revised reporting template designed to capture the required Section 3 reporting data. Of those 12, only six subgrantees reported any Section 3 data.

HUD's guidance on Section 3 reporting says, "State and county agencies must report to HUD on the cumulative Section 3 activities within their jurisdiction on an annual basis.... Section 3 reports must be submitted by all agencies that receive Community Planning and Development funding in excess of \$200,000 whether the requirements were triggered or not." According to the guidance, the Department should have submitted an annual Section 3 Summary Report for 2009 even though there were no Section 3 activities performed by the subgrantees during 2009. Failure to comply with the requirements of Section 3 may result in sanctions including debarment, suspension, or limited denial of participation in HUD programs.

Recommendation

NSP should submit Section 3 Summary Reports to HUD in accordance with HUD's guidance in order to ensure that the Department complies with federal program requirements.

Status:

04/08/11 - Management concurs. The Program Services Division is coordinating with the Housing Resource Center to prepare the 2009 and 2010 Section 3 report for the Department. The Department established a Board policy on Section 3 in December of 2010 and immediately thereafter launched a website to inform and collect information for all Section 3 impacted programs. NSP subgrantees have been informed via a listserv announcement of the new website and the policy which reiterated requirements already in their contracts

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
189	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 5-B
The Department Should have Followed the \$525,000 Minimum Award Amount

Although not required by HUD, the Department's NOFA set a minimum NSP contract amount of \$500,000 plus \$25,000 in administration fees for a total contract of \$525,000. However, of the 48 randomly selected contract files tested, one original contract was written for less than \$525,000. The NSP NOFA states that "In order to avoid allocating small amounts of funding that can have no meaningful impact on stabilizing of property values, the minimum award amount to an eligible entity cannot be less than \$500,000, excluding administration cost."

Although the Texas Administrative Code for NSP allows the Department to issue a waiver of certain contract terms required in the 2009 NSP NOFA, the stricter requirements of the NOFA may have deterred potential subgrantees from applying for grant funds and could have resulted in fewer areas served by the NSP.

Recommendation

The Department should abide by the NOFA to ensure the subgrantees understand the Department's intent and that all subgrantees are offered an equal opportunity to participate under the same set of rules.

Status:

04/08/11 - Management concurs and will ensure that any future subgrantee abides by the requirements of the applicable NOFA

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
190	4/8/2011 Internal Audit	An Audit of the Neighborhood Stabilization Program To determine whether the Department is operating effectively and in compliance with laws, r	Px	04/08/11 3/31/2011
			Ix	04/22/11

Division: Neighborhood Stabilization

Section:

Issue: Chapter 5-C
NSP Should Confirm Contract Terminations in Writing

NSP management did not consistently abide by the contract terms for termination of a contract. Specifically, a subgrantee requested that its NSP contract with the Department be terminated but the Department failed to issue a letter confirming the termination as required by the contract.

The contract between TDHCA and each subgrantee indicates that, "either of the parties to this contract shall have the right to terminate this contract when both parties agree that the continuation of the activities funded under this contract would not produce beneficial results commensurate with the further expenditure of funds; provided that both parties agree, in writing, upon the termination conditions, including the effective date of such termination."

NSP management acknowledged termination of the contract via a phone call, but did not ensure that the required letter was sent in order to complete the termination process. As a result, the termination process for this contract is not complete.

Recommendation

The Department should abide by the contract terms and confirm the termination of any NSP contract in writing

Status:

- 04/22/11 - All terminated TDHCA SNP contracts have been reviewed for proper documentation of status. Three contracts were found to not have been documented in writing as terminated. Two additional contracts were terminated; however, these were not funding terminations, but rather conversions from a subrecipient contract format to a developer agreement (principally for program income reporting purposes). The 3 funding terminations and 2 developer agreements that were not previously documented have been documented in the contract files.
- 04/08/11 - Management agrees and will review all contract files to ensure that all contracts administered by TDHCA requiring termination have been documented in writing as terminated by March 31, 2011.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
191	4/12/2011 Internal Audit	An Internal Audit of the Weatherization Assistance Program Report # 11-1041 WAP contracts for program years 2008, 2009, 2010, and ARRA-WAP contracts for period be	Px	04/12/11 5/1/2011

Division: Community Affairs

Section: Energy Assistance - WAP

Issue: EA program officers use a monitoring instrument to perform and document their monitoring. Although the monitoring instrument is comprehensive, there are opportunities for enhancement in the procedures.

The monitoring instrument requires the program officers to review two months of expenditures, cash disbursement journals, and supporting documentation. A review of two months is a limited picture of the general ledger. Internal audit expanded the procedure to include a review of the entire general ledger for WAP, and found at one subrecipient the beginning and ending balances from month to month did not always match, and significant journal entries were used to transfer funds among multiple funding sources.

We compared a list of the subrecipient's employees' information with the information of clients who received weatherization services. At one subrecipient, there were eight (1.8%) address matches with 451 completed units. At another subrecipient, there were three (0.6%) address matches with 508 completed units. Although subrecipients may have employees who meet the WAP eligibility requirements, it is important to ensure that they received services in accordance with the Department of Energy (DOE) guidelines.

We conducted interviews with subrecipient staff and contractors to identify processes and internal controls used in the management of the WAP for testing. We noted during the interviews that at one subrecipient, a contractor responsible for assessments was unable to describe the process used to assess a home for weatherization. We also noted subrecipients were requesting additional client documentation not required by DOE guidelines. During testing we also identified some subrecipients not following their own procedures.

Recommendation:

EA should consider expanding their WAP monitoring procedures to include the following:

- request, review, and select a sample from the entire general ledger for the program year under review,
- identify subrecipient employees who received weatherization services and review those client files to ensure that eligibility and prioritization was determined in accordance with DOE guidelines, and
- gain a sufficient understanding of the subrecipient's processes through staff and contractor interviews to identify internal controls, and ensure those controls are in place and are working as intended.

Status:

04/12/11 - Community Affairs Management agrees with the recommendation to modify the WAP monitoring procedures to include a sample from the entire General Ledger for the program year. Program officers will look for unusual trends or transactions that warrant further inspection or require clarification. Management also concurs with the identification and increased scrutiny on subrecipient employees that receive weatherization services. Staff will request and review each of the files in order to ensure that proper documentation was received and proper procedures were followed in accordance with the DOE guidelines and Texas Administrative Code requirements. Management also recognizes the value of staff interviews to identify internal controls and to validate the effectiveness of the internal controls and will strive to integrate those into current processes.
The Project Manager for Monitoring will update the monitoring instrument to reflect the revised procedures and provide instructions to the monitors on how to implement properly the new procedures for General Ledger request and reviews. This target date for implementation is May 1, 2011.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
192	4/12/2011 Internal Audit	An Internal Audit of the Weatherization Assistance Program Report # 11-1041 WAP contracts for program years 2008, 2009, 2010, and ARRA-WAP contracts for period be	Px	04/12/11

Division: Community Affairs

Section: Energy Assistance - WAP

Issue: We performed a review of the monitoring instrument used by program officers during full on-site monitoring visits of WAP subrecipients to determine the existence and the sufficiency of procedures intended to prevent, detect, and deter fraud, waste, or abuse. Many of the procedures contained in the monitoring instrument are designed to identify potential instances of fraud, waste, or abuse. However, when we conducted a survey of the Department's WAP program officers and unit inspectors with specific questions related to procedures for the detection and prevention of fraud, waste, or abuse, the respondents' answers varied widely. The responses for detection fell into one of the following general categories: by following the monitoring instrument, by performing comparisons and reconciliations, through conversations with subrecipient staff, and by identifying and testing anomalies and/or perceived weaknesses. The wide variation between responses suggests that specific detection procedures should be more effectively communicated to the program officers or unit inspectors.

When asked about procedures for preventing fraud, waste, or abuse, most program officers and unit inspectors cited the various monitoring procedures they mentioned previously regarding detection. Few program officers or unit inspectors addressed how they prevent fraud, waste or abuse from occurring in the first place. Therefore, the results suggest that the WAP does not have clear procedures for subrecipient education or prevention.

In addition, the WAP does not have a centralized location to track or document the status, action taken, or outcome of fraud, waste, or abuse allegations and investigations. We requested all information related to fraud, waste, or abuse allegations for program years 2008- present and obtained a list of investigation documentation from WAP management. WAP management noted that it does not maintain fraud, waste, or abuse documentation in a centralized location. It is important that fraud, waste, or abuse allegations received by WAP be maintained in a centralized location to ensure that all allegations are tracked, investigated, and resolved as appropriate. In addition, these allegations should be shared with the appropriate Department staff as required by the Department's policy.

Recommendations:

The Division should:

- a) develop, finalize, and distribute strengthened procedures for the prevention and detection of fraud, waste, or abuse including a process for tracking, investigating, and resolving any allegations brought directly to the program officers or Division management.
- b) develop and implement enhanced procedures for subrecipient education regarding fraud, waste or abuse prevention and detection, and
- c) establish a centralized location to track all WAP fraud, waste, or abuse allegations.

Status:

04/12/11 - Management agrees with the recommendations and will develop procedures for the prevention and detection of fraud, waste, and abuse, including development of a centralized process for tracking investigations and documentation of the resolution of identified instances. The database will reside in an agency drive with "read only" access for all Community Affairs staff and will be editable by limited staff in order for management to ensure, timely, thorough, and proper documentation and subsequent resolution of identified instances. The Office of ARRA Accountability and Oversight has already developed, finalized and distributed the procedures for subrecipient education regarding fraud, waste, and abuse. These documents were provided to the subrecipient network on April 4, 2011.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
193	4/12/2011 Internal Audit	An Internal Audit of the Weatherization Assistance Program Report # 11-1041 WAP contracts for program years 2008, 2009, 2010, and ARRA-WAP contracts for period be	Px	04/12/11 5/1/2011

Division: Community Affairs

Section: Energy Assistance - WAP

Issue: When a complaint is received, WAP management will assign the complaint to one of the WAP program officers for follow-up. Documentation of the complaint is the responsibility of the program officer who was assigned to the complaint.

We conducted a survey of the 18 WAP program officers and unit inspectors with specific questions related to complaint tracking and resolution. Most respondents stated that they receive complaints "sometimes" to "regularly." However, the procedures for tracking, investigating and resolving complaints varied among the respondents.

The survey results indicate a clear complaint escalation process is not in place. When asked, "Who do you notify when you receive a WAP related complaint?" Six of the 14 respondents (43%) stated that their approach to handling the complaint depends on the complaint type. For example, sometimes the respondent will notify management of the complaint and sometimes they handle the complaint independently. Four respondents (29%) stated that they notify management for every complaint received and two respondents (14%) said management notifies them of complaints. One respondent (7%) stated that he/she typically notifies the program officer who is assigned to the subrecipient indicated in the complaint. One respondent (7%) did not answer this question.

Similarly, a wide range of survey responses indicates that a clear complaint tracking process is not in place. When asked, "How do you track complaints?" Six of the 14 respondents (43%) stated they do not track complaints and the remaining five (36%) cited a range of methods including personal calendars, e-mail, notes to self, and a phone contact log.

A set complaint investigation approach or timeframe also appears to be lacking. When asked, "How do you follow-up on and resolve complaints?" of the 14 respondents, six (43%) stated they typically resolve complaints in 0-5 days, three (21%) stated they take 6-10 days, two (14%) said they take 11-15 days, and two (14%) said they take 16-20 days. Their methods for resolving complaints ranged from phone calls to verifications to written responses.

The WAP does not maintain complaint information in a centralized location. We attempted to perform a review of all WAP complaints for program years 2008 to present. However, WAP management was unable to provide a complete population of the complaints because they are documented in various locations and often in individuals' e-mail. The WAP should track all complaint information in a centralized location in order to ensure that all complaints are tracked, investigated, and resolved.

Recommendation

The Division should develop, finalize, and distribute procedures for the tracking, investigation, and resolution of complaints and establish a centralized location to track all complaints received by the program officers or Division management, including information regarding the investigation and resolution of the complaint.

Status:

04/12/11 - Management agrees with the recommendations and will develop procedures for the tracking, investigation and resolution of complaints including development of a centralized process for tracking investigations and the documentation of the resolution of complaints. The database will reside in an agency drive with "read only" access for all Community Affairs staff and will be editable by limited staff in order for management to ensure, timely, thorough and proper documentation and subsequent resolution of identified instances.

The Manager of the Energy Assistance Section will develop procedures for the tracking, investigation and resolution of complaints. Additionally, the Manager of Energy Assistance will initiate a centralized tracking system for all complaints. The target date for implementation is May 1, 2011